SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1931

No. 341

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

VS.

CORONADO OIL AND GAS COMPANY

WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE DISTRICT OF COLUMBIA

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[Caption omitted.]

Before United States Board of Tax Appeals

Docket No. 10503

CORONADO OIL AND GAS COMPANY, CLEVELAND, OKLA.

v.

COMMISSIONER OF INT. REV.

For Taxpayer: H. L. Bolen, Esq., S. M. Hayes, Esq., T. P. Gore, Esq., D. A. Richardson, Esq.
For Commissioner: Max E McDowell, Esq., W. F. Gibbs, Esq., D. H. Green, Esq.
Mr, Green (Member) transferred to Mr. Trussell 10-26-28.

Docket entries

1925
Dec. 31. Petition received and filed.

1926
Jan. 8. Copy of petition served on solicitor.
" 8. Notification of receipt mailed taxpayer.
" 28. Answer filed by solicitor.
Feb. 3. Copy of answer served on taxpayer—assigned to field cal.
Dec. 17. Motion for leave to file amended petition filed, amendment tendered.
" 18. Hearing set for 2-8-27 at Oklahoma City.
" 21. Granted. Both sides notified.
" 22. Copy of motion and amended petition served on G. C.

2 1927
Mar. 22. Transcript of hearing 2-3-27 filed.
Apr. 12. Motion for an extension to 5-4-27 to file brief, filed by taxpayer.
" 12. Brief filed by general counsel.
" 13. Granted. Both sides notified.
Sept. 7. Ordered case be restored to trial cal. for argument at a time agreed upon—signed and filed. Both sides notified. See 3707.
Nov. 12. Brief filed by taxpayer.
" 29. Hearing had before Mr. Green on merits. Submitted.
Dec. 5. Transcript of hearing 11-29-27 filed.

1929

Jan. 14. Findings of fact and opinion rendered. Mr. Trussell. Judgment under rule 50.
Mar. 25. Notice of settlement filed by G. C.
" 28. Hearing set 4-23-29.
Apr. 20. Motion for continuance to 5-13-29 filed by taxpayer. 4-23-29 Granted.
" 23. Hearing had before Mr. Phillips on settlement under rule 50; by consent continued 5-13-29.
May 13. Hearing held before Mr. Arundell on settlement under rule 50; not contested, assigned Mr. Trussell for order.
" 14. Decision entered, Summer L. Trussell, div. 6.
Oct. 30. Stipulation of venue filed—Ct. of Appeals, D. C.
" 30. Petition for review by Ct. of Ap. D. C. with assignments of error filed by taxpayer.
" 30. Proof of service filed.
Nov. 19. Statement of evidence lodged.
" 19. Notice of lodgment of statement of evidence with hearing set 11-30-29.
" 30. Order continuing to day cal. of Dec. 4, 1929, entered.
Dec. 5. Agreed statement of evidence approved and ordered filed.
" 5. Agreed praecipe filed.
" 5. Proof of service of agreed praecipe filed.

3 Now, December 9, 1929, the foregoing docket entries certified from the record as a true copy.

[Seal U. S. Board of Tax Appeals.]

B. D. Gamble,
Clerk U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

Docket No. 10503

APPEAL OF CORONADO OIL & GAS COMPANY, CLEVELAND, OKLAHOMA

Petition

Filed Dec. 31, 1925

The above named taxpayer appeals from the determination of the Commissioner of Internal Revenue set forth in his deficiency letter (IT:CA-2558-1-60D) dated November 13, 1925, and as the basis of its appeal sets forth the following:

1. The taxpayer is an Oklahoma corporation with principal offices at Cleveland, Oklahoma.

2. The deficiency letter (a copy of which is attached hereto), is dated November 31, 1925, the date of mailing to the taxpayer being unknown.

3. The taxes in controversy are income and profits taxes for the calendar years 1917, 1918, and 1919 and are more than $10,000.00, viz:

	Amount
1917	$ [illegible]
1918	3,398.60
1919	2,690.52

4. The determination of tax contained in said deficiency letter is based upon the following errors:

(a) The Commissioner of Internal Revenue did not include the difference between the par value of the capital stock and the market value of the assets received in exchange therefor, amounting to $55,800.00, as paid in surplus in determining the invested capital for the years 1917, 1918, and 1919.

(b) The Commissioner of Internal Revenue allowed depreciation at the rate of 10% per annum on the lease equipment, based on the cost of the equipment to the individuals who acquired same from the former lease owner, amounting to $55,800.00, instead of the market value of the equipment transferred to the corporation in exchange for its capital stock, bonds and note, amounting to $111,600.00, which resulted in an increase in the taxable income for the year 1917 amounting to $5,580.00, year 1918 $5,580.00, year 1919 $5,580.00.

(c) The Commissioner of Internal Revenue included in the taxable income for the calendar years 1917, 1918, and 1919 the amounts of $15,949.68, $22,413.94, and $13,500 [illegible]8, respectively, which amounts were income or profits the taxpayer derived from school land owned by the State of Oklahoma and leased for oil and gas purposes and are exempt from taxation by the United States.

5. The facts upon which the taxpayer relies as its basis of appeal are as follows:

(a) On January 9, 1914, G. W. Sutton, acting for himself, J. B. Myers, R. L. Lunsford, and John R. Williams, all of Cleveland, Oklahoma, made an application to the commissioners of the land office of the State of Oklahoma to lease for oil and gas purposes, under the laws of the State of Oklahoma, and the rules and regulations of the commissioners of the land office, the following described lands:

The S. ½ of the NW. ¼; SW. ¼, NE. ¼, S. ½ of SE. ¼ of section 16, township 21 north, range 8 east, Pawnee County, Oklahoma.

The rules and regulations of the commissioners of the land office governing the bidding on the lease on the above described lands provided for the payment of $55,800.00 by the successful bidder to the Southwestern Oil Fields Company, former lessee, for the equipment on the lease.

G. W. Sutton was the successful bidder and the commissioners of the land office at a meeting held on January 19, 1914, authorized and directed the chairman and secretary to enter into a lease contract

with G. W. Sutton for a term of five years and to fix his bond at $10,000.00.

After possession of the lease and improvements had been delivered to Mr. Sutton the amount of $55,800.00, deposited by him with the commissioners of the land office, was paid over to the Southwestern Oil Fields Company for the improvements on the lease.

At the request of G. W. Sutton the lease awarded him on the above described lands was made to the Coronado Oil and Gas Company.

The considerations received by the four individuals mentioned above, in exchange for this lease made by the State of Oklahoma to the Coronado Oil and Gas Company consisted of the following items:

Bonds of the corporation in the amount of $25,000.00.

Note of the corporation in the amount of $5,800.00.

Capital stock of the corporation of the par value of $25,000.00.

However, the capital stock of the corporation had a fair market value of $80,800.00 at the time of issue, which value was based on the fair market value of the equipment on the lease exchanged therefor, which amounted to $111,600.00 at the time of the exchange.

This valuation of $111,600.00 on the equipment was made in good faith by the above mentioned four individuals and this amount was entered in the "equipment account" on the books of the corporation as the cost of the equipment.

The amount of $55,800.00 representing the excess of the cost of the equipment over the total of the par value of the stock and the bonds issued, and the face value of the note executed, was credited to the paid up surplus account, thus placing the value of $80,800.00 on the capital stock issued at the date of issue.

(b) Under the provisions of the enabling act approved June 16, 1906, upon admission of the State of Oklahoma to the Union, sections 16 and 36 in every township in Oklahoma Territory and all indemnity lands theretofore selected in lieu thereof were granted to the State of Oklahoma for the use and benefit of the common schools.

The enabling act further provided that such sections 16 and 36 and the lands taken in lieu thereof which were granted for the
6 support of the common schools, if sold, should be appraised and sold at public sale. The proceeds were to constitute a permanent school fund, interest on which only should be expended in support of such schools. But said lands might, under such regulations as the legislature prescribed, be leased for a period not to exceed ten years and such lands should be reserved for school purposes only.

However, the above provisions were subjected to the following limitations:

Where any part of the lands granted by this act to the State of Oklahoma were valuable for minerals, gas or oil, such lands should not be sold by the said State prior to January 1, 1915, but the same

might be leased for a period not to exceed five years by the State officers duly authorized for that purpose, and all proceeds from leases should be covered to the fund to which they should properly belong and no transfer or assignment of any lease should be valid or confer any right in the assignee without the consent of the proper State authorities in writing.

Section 16, township 21 north, range 8 east, Pawnee County, State of Oklahoma, was included in the lands granted to the State of Oklahoma under the provision of the enabling act as set forth above, and the part of said section 16 included in the lease from the State of Oklahoma to the taxpayer was still owned and held by the State for the use and benefit of the common schools during the years 1917, 1918, and 1919.

The lease for oil and gas purposes on the S. ½ of the N. W. ¼; S. W. ¼, N. E. ¼, S. ½ of the S. E. ¼ of section 16, township 21 north, range 8 east, Pawnee County, State of Oklahoma, between the taxpayer and the State of Oklahoma was made in accordance with the terms and conditions of the enabling act and the statutes of the State of Oklahoma.

The State of Oklahoma through its school land commissioners employed the taxpayer to develop the leased premises for oil and gas. The lease specified a fixed royalty determined, as the law provided, by the commissioners of the land office and stipulated that the

lessee should have and receive the balance of any production
7 as compensation for its risk, services and outlay in connection with such development and operations.

The taxpayer executed to the State, as required by law, a good and sufficient bond for the faithful performance of such lease. The lease was subject to forfeiture for breach of conditions, and could not be assigned or transferred without the consent in writing of the commissioners of the land office.

(c) The total net income or profits of the taxpayer for the calendar years 1917, 1918, and 1919 was derived from the sale or disposition of its share of the oil and gas received under its lease on the S. ½ of the NW. ¼; SW. ¼, NE. ¼, S. ½ of the SE. ¼ of section 16, township 21 north, range 8 east, Pawnee County, State of Oklahoma.

The taxpayer had no income from any source other than the lease on the above described lands during the years 1917, 1918, and 1919.

The amount of the net income of the taxpayer from this lease, as determined by the Commissioner of Internal Revenue and set forth in his deficiency letter dated November 13, 1925, for each of the years in question was as follows:

Year	Amount
1917	$15,949.69
1918	22,413.94
1919	13,500.88

6. The taxpayer, in support of its appeal, relies upon the following propositions of law:

(a) That as used in this title the term "invested capital" for any year means the actual cash value of tangible property, other than the cash, bona fide paid in for stock or shares, at the time of such payment, but in no case to exceed the par value of the original stock or shares specifically issued therefor, unless the actual cash value of such tangible property at the time paid in is shown to the satisfaction of the commissioner to have been clearly and substantially in excess of such par value, in which case such excess shall be treated as paid-in surplus.

(b) That in computing the net income there shall be allowed
8 as deductions: in the case of mining, oil, gas leases and other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost, including cost of development not otherwise deducted.

(c) When the source of the income is exempt from taxation the income itself is exempt from taxation. School land owned by a sovereign State is not subject to taxation by the United States.

Income and profits derived from such tax exempt school lands under an oil and gas mining lease are not subject to tax by the United States.

Wherefore the taxpayer respectfully prays that this board may hear and determine its appeal.

HUBERT L. BOLEN,
HUBERT L. BOLEN,
Counsel for Taxpayer.
621 Tradesmens Natl. Bank Bldg.,
Oklahoma City, Oklahoma.

[*Duly sworn to by R. L. Lunsford; jurat omitted in printing.*]

8–A Copy

STATEMENT

IT: CA: 2558–1–60–D.

In re: Coronado Oil and Gas Company, Cleveland, Oklahoma.

Years examined	Deficiency in tax
1917 (waiver expires 12–31–25)	$6,152.76
1918 (waiver expires 12–31–25)	8,398.60
1919 (waiver expires 12–31–25)	2,690.42
Total	17,241.78

Year ended December 31, 1917

SCHEDULE #1

Net income:	
Net income as disclosed by books as shown by agent's report dated April 22, 1922	$16,209.76
As corrected	15,949.69
Net deductions	260.07

Deductions:		
a. Additional depletion allowable	$260.07	
Total deductions		260.07
Net deductions as above		260.07

Explanation of items changed

a. Depletion allowed by revenue agent	$399.34
b. Depletion allowable	659.41
Additional depletion allowable	260.07

Depletion is computed for this year on the capitalized cost of drilling in the amount of $5,127.27, and estimated recoverable reserves at beginning of the year of 224,630 barrels, and a production of 28,896 barrels, or a unit of cost of $0.02282.

SCHEDULE #2

Invested capital

Invested capital disclosed by books. Agent's report dated April 22, 1922		$35,142.56
As corrected		25,000.00
Net reductions, as explained below		142.56
Reductions:		
8. Earned surplus reduced by operating deficit, as shown by adjusted balance sheet	$142.56	
Total reductions as above		142.56

SCHEDULE #3

Computation of tax, 1917 act

Excess profits tax

Corporation:	
Net income taxable year, (Schedule 1)	$15,949.69
Net income subject to excess profits tax	15,949.69
Invested capital (Schedule 2)	25,000.00
Variable deduction, 8%	2,000.00
Specific exemption	3,000.00
Total deduction	5,000.00

	Income	Deductions	Balance	Rate	Tax
15%	$3,750.00	$3,750.00		20%	
5%	1,250.00	1,250.00		25%	
5%	1,250.00		$1,250.00	35%	$437.50
5%	2,000.00		2,000.00	45%	900.00
Balance	7,699.69		7,699.69	60%	4,619.81
Totals	15,949.69	5,000.00			5,957.31

SCHEDULE #4

Computation of tax, 1917

Total tax

		Tax
Taxable net income (Schedule 1)	$15,949.69	
Deduct:		
Excess-profits tax (Schedule #3)	5,957.31	$5,957.31
Taxable at 2%	9,992.38	199.85
Taxable at 4%	9,992.38	399.70
Total tax liability		6,556.86
Previously assessed		404.10
Deficiency in tax		6,152.76

Year ended December 31, 1918

SCHEDULE #1

Net income:	
Net income as disclosed by books, as shown by revenue agent's report dated April 22, 1921	$22,715.34
As corrected	22,413.94
Net deductions	301.40
Deductions:	
a. Additional depletion allowable	301.40
Total deductions	301.40

Explanation of items

a. Depletion allowed by revenue agent	$462.80
b. Depletion allowable	764.20
Additional depletion allowable	301.40

Depletion is computed for this year on the capitalized cost of drilling in the amount of $4,467.96 as at the beginning of the year and estimated recoverable reserves at the beginning of the year 195,734 barrels, and a production of 33,488 barrels, or a unit cost of $.02282.

SCHEDULE # 2

Invested capital

Invested capital disclosed by books, as shown by agent's report dated April 22, 1921		$37,313.40
As corrected		36,107.03
Net reductions as explained below		1,206.37
Additions:		
a. Difference in prorating 1917 income tax	$130.62	
Total additions		130.62
Deductions:		
b. Dividend paid November 4, 1918, prorated	1,336.99	
		1,336.99
Net reductions as above		1,206.37

Explanation of items changed

a. Difference in prorating corrected income and excess profits taxes.
b. Dividend of $20,000.00 paid November 4, 1918, prorated out of invested capital, after applying thereto the available earnings to date of payment less tentative tax.

SCHEDULE # 3

War profits credits, 1918 act

Adjusted invested capital taxable year (Schedule 2)	$36,107.06
Average adjusted prewar capital	None.
Average net income prewar period	None.
10% of invested capital	3,610.70
Exemption	3,000.00
War profits credit	6,610.70

SCHEDULE # 4

Computation of tax, 1918 rates

Excess profits tax

Net income (Schedule 1)	$22,413.94
Invested capital (Schedule 2)	36,107.06
8% of invested capital	2,888.56
Exemption	3,000.00
	5,888.56

Computation of tax under section 301

	Income	Credit	Taxable	Rate	Tax
20%	$7,221.41	$5,888.56	$1,332.85	20%	$399.86
Balance	15,192.53		15,192.53	65%	9,875.14
Total	22,413.94				10,275.00

War profits tax

Net income (Schedule 1)	$22,413.94	
Less credit (Schedule 3)	6,610.70	
Taxable at 80%	15,803.24	$12,642.59
Less: Excess profits tax		10,275.00
War profits tax		2,367.59
Profits tax computed under section 301		12,642.59

Computation of tax under section 302

		Rate	Tax
Income up to $20,000.00; credit $3,000.00; taxable	$17,000.00	30%	$5,100.00
Balance $2,413.94	2,413.94	80%	1,931.15
Profits tax under section 302			7,031.15

Income tax

Net income taxable year	$22,413.94	
Less:		
War profits tax and excess profits tax	7,031.15	
Exemption	2,000.00	
Total	9,031.15	
Balance taxable at 12%	13,382.79	
Income tax		$1,605.93
Total profits and income tax		8,637.08
Previously assessed		238.48
Deficiency in tax		8,398.60

Year ended December 31, 1919

SCHEDULE No. 1

Net income:		
Net income as disclosed by books as shown by revenue agent's report dated April 22, 1921		$14,066.77
As corrected		13,500.88
Net deductions		565.89
Deductions:		
a. Additional depletion allowable	$565.89	
Total deductions		565.89

Explanation of items changed

a. Depletion allowed by revenue agent	685.40
b. Depletion allowable	1,251.29
	565.89

Depletion is computed for this year on the cost of lessees capitalized cost of drilling in the amount of $11,584.81, and estimated recoverable reserves at the beginning of the year of 162,246 barrels, and a production of 17,525 barrels, or a unit cost of $.0714.

SCHEDULE No. 2

Invested capital

Invested capital disclosed by books as shown by revenue agent's report dated April 21, 1921		$33,229.61
As corrected		39,664.43
Net additions as explained below		6,434.82
Additions:		
a. Reserve for Federal income and excess-profits taxes	$6,329.86	
b. Differences in prorating 1918 Federal income and excess profits taxes	104.96	
Total additions		6,434.82
Net additions as above		6,434.82

Explanation of items changed

a. Invested capital has been increased by the reserve for Federal income and excess profits taxes, as shown on the adjusted balanced sheets prepared by the revenue agent.

b. Difference in prorating corrected 1918 Federal income and excess-profits taxes of $8,637.08.

SCHEDULE No. 3

Computation of tax, 1919 rates

Excess profits tax

Net income, Schedule 1	$13,500.88
Invested capital, Schedule 2	39,664.43
8% of invested capital	3,173.15
Plus exemption	3,000.00
Total credit	6,173.15

% of capital	Income	Credit	Taxable	Rate	Tax
20%	$7,932.89	$6,173.15	$1,759.74	20%	$351.95
Balance	5,567.99		5,567.99	40%	2,227.20
Total	13,500.88	6,175.15	7,327.73		2,579.15

Tax computed under section 302

Net income	$13,500.88	
Less exemption	3,000.00	
Balance subject to tax at 20 per cent	10,500.88	$2,100.18

Income tax

Net income taxable year	13,500.88	
Less:		
Profits tax	2,100.18	
Exemption	2,000.00	
Balance taxable at 10 per cent	9,400.70	
Income tax		940.07
Total income and excess-profits tax		3,040.25
Previously assessed		349.83
Deficiency in tax		2,690.42

In arriving at the above adjustments your protests and all the evidence submitted have been carefully considered.

The bureau has ruled that inasmuch as you acquired your properties for stock, bonds, and a note, that you are entitled to set up as the value of the assets acquired, the then actual cash value as of the date of the transaction. The State appraised your properties at $55,800 and the selling of them to Mr. Sutton for this figure a few days before you acquired them is considered the best evidence available as to the value of the assets when acquired by you. Therefore, your claim for paid-in surplus is denied.

Further, inasmuch as it appears that you are the original lessee, no paid-in surplus may be allowed with respect to your lease. (See page 288, A. R. R. 86, Cumulative Bulletin #2.)

You are also advised that the bureau has consistently held that the income or profits accruing to a lessee derived from the production of oil and gas from school lands owned by the State of Oklahoma is not exempt from Federal income tax.

Payment of the deficiency in tax should not be made until a bill is received from the collector of internal revenue for your district and remittance should then be made to him.

Now, December 9, 1929, the foregoing petition certified from the record as a true copy.

B. D. GAMBLE,
Clerk, United States Board of Tax Appeals.

9

Copy

Form NP-2

Treasury Department, Washington

Refer to IT:CA:2558-1-60-D.

Nov. 13, 1925.

CORONADO OIL AND GAS COMPANY,
Cleveland, Oklahoma.

SIRS: The determination of your income tax liability for the years 1917, 1918, and 1919, pursuant to an examination of your books of account and records, as set forth in bureau letter dated December 23, 1922, disclosed a deficiency in tax aggregating $17,241.78, as shown in the attached statement.

In accordance with the provisions of section 274 of the revenue act of 1924, you are allowed 60 days from the date of mailing of this letter within which to file an appeal to the United States Board of Tax Appeals contesting in whole or in part the correctness of this determination.

Where a taxpayer has been given an opportunity to appeal to the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has appealed and an assessment in accordance with the final decision on such appeal has been made, no claim in abatement in respect of any part of the deficiency will be entertained.

If you acquiesce in this determination and do not desire to file an appeal, you are requested to sign the inclosed agreement consenting to the assessment of the deficiency and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:CA:2558-1-60-D. In the event that you acquiesce in a

part of the determination, the agreement should be executed with respect to the items agreed to.

Respectfully,

D. H. BLAIR,
Commissioner.

(Signed) By C. R. NASH,
Assistant to the Commissioner.

Inclosures: Statements. Agreement—Form A.

(Here follow pages Nos. 12, 13, 14, 15, 16, 17, 18, and 19.)

10 Before United States Board of Tax Appeals

[Title omitted.]

Answer

Filed Jan. 28, 1926

Now comes the Commissioner of Internal Revenue, by his attorney, A. W. Gregg, Solicitor of Internal Revenue, and for answer to the petition of this taxpayer, admits and denies as follows:

(1) Admits the allegations contained in paragraphs 1, 2, and 3 of the taxpayer's petition.

(2) Denies that the commissioner erred in disallowing $55,800.00, alleged paid-in surplus claimed by the taxpayer for the purpose of computing invested capital for the years 1917, 1918, and 1919.

(3) Denies that the commissioner erred in allowing depreciation on lease equipment based only on a valuation of such assets amounting to $55,800.00.

(4) Denies that the commissioner erred in including in taxable income for the calendar years 1917, 1918, and 1919 the amounts of $15,949.68, $22,413.94, and $13,500.88, respectively, which amounts represent income of this taxpayer.

(5) Denies the material allegations of fact contained in paragraph 5 of the taxpayer's petition.

(6) Denies generally and specifically each and every allegation contained in the taxpayer's petition not hereinbefore admitted, qualified, or denied.

Propositions of law

(1) The commissioner properly excluded from invested capital of this taxpayer $55,800.00, alleged by the taxpayer to constitute paid-in surplus.

(2) In the case of oil and gas leases, there shall be allowed as deductions in computing net income, a reasonable allowance
11 for depletion and for depreciation of improvements, according to the peculiar conditions in each case based upon cost, including cost of development, not otherwise deducted.

(3) Income derived by a lessee through the exploitation of oil wells located on school land owned by the State of Oklahoma is

subject to the income tax imposed by the revenue acts of 1917 and 1918.

Wherefore it is prayed that this taxpayer's appeal be denied.

A. W. GREGG,
Solicitor of Internal Revenue,
Attorney for Commissioner of Internal Revenue.

Of counsel:

THOMAS M. WILKINS,
Special Attorney, Bureau of Internal Revenue.

Now, December 9, 1919, the foregoing answer certified from the record as a true copy.

[Seal United States Board of Tax Appeals.]

B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

[Title omitted.]

Amended petition

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice (IT:CA-2658-1-60 D) dated November 13, 1925, and as a basis of its proceeding, alleges as follows:

(1) The petitioner is a corporation, organized and existing under the provisions of the laws of the State of Oklahoma, with its principal office at Cleveland, Oklahoma.

12 (2) The notice of deficiency (a copy of which is attached and marked Exhibit A) is dated November 13, 1925, the date of mailing to the petitioner being unknown.

(3) The taxes in controversy are income and profits taxes for the calendar years 1917, 1918, and 1919 and are approximately $18,234.19 as shown below:

Year	Amount
1917	$6,566.86
1918	3,627.08
1919	8,040.25
Total	18,234.19

(4) The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) The Commissioner of Internal Revenue erroneously included in the taxable net income of the petitioner for the calendar years 1917, 1918, and 1919, the amounts of $15,949.69, $22,413.94, and $18,500.88, respectively. The entire net income or profit of the petitioner for the calendar years 1917, 1918, and 1919, which the Commissioner of Internal Revenue has determined to be the amounts stated above, was the income or profit derived by the petitioner from

school land owned by the State of Oklahoma and leased by the petitioner from the State of Oklahoma for oil and gas purposes and as such is exempt from taxation by the United States.

(b) In computing the invested capital of the petitioner for the calendar years 1917, 1918, and 1919, the Commissioner of Internal Revenue did not include therein the paid-in surplus amounting to $58,538.00. This paid-in surplus is represented by the fair market value of the development on an oil and gas lease which amounted to $58,538.00 on the date the lease was acquired. This development of the value stated above and the physical equipment on this lease, the value of which is admitted by the Commissioner of Internal Revenue to be $55,800.00, was acquired by the petitioner in exchange for its capital stock of the par value of $25,000.00, bonds of the petitioner of the face value of $25,000.00 and the note of the petitioner for the amount of $5,800.00.

13 (c) In computing the invested capital of the petitioner for the calendar year 1918 the Commissioner of Internal Revenue erroneously deducted from the invested capital of the beginning of the year the amount of $3,559.22 as an adjustment for the 1917 tax prorated. If the income from this source is held to be taxable the correct amount to be deducted is $608.66 or a difference of $2,950.56.

(d) In computing the invested capital of the petitioner for the calendar year 1918, the Commissioner of Internal Revenue erroneously deducted from the invested capital of the beginning of the year the amount of $1,336.99 as an adjustment for the amount of a dividend paid November 4, 1918 out of capital prorated. The Commissioner of Internal Revenue erroneously deducted the amount of a tentative tax from the available earnings to the date of the dividend payment and applied only the remainder of such earnings to the amount of the dividend paid. The correct amount to be deducted is $648.05 or a difference of $688.94.

(c) In computing the invested capital of the petitioner for the calendar year 1919, the Commissioner of Internal Revenue erroneously deducted from the invested capital of the beginning of the year the amount of $3,650.05 as an adjustment for the 1918 taxes prorated. If the income from this source is held to be taxable, the correct amount to be deducted is $2,612.04 or a difference of $1,038.01.

(f) The amount of tax assessed (and paid) by the petitioner for the calendar year 1918 is understated by the Commissioner of Internal Revenue in the deduction from the total tax determined, to arrive at the amount of the deficiency shown in the deficiency notice. The amount of the tax paid by the petitioner for the year 1918 was $311.09, no part of which has been refunded. The amount of tax assessed and deducted from the total tax determined as shown by the deficiency notice was $238.48, an understatement of $72.61.

(g) The amount of the Federal income tax for the calendar year 1918, which was paid during the year 1919, was overstated in the revenue agent's report in his computation of the net taxable income

of the petitioner for the calendar year 1919 by the amount of $178.50. The revenue agent disallowed as a deduction the amount of $489.59 as Federal income tax for the year 1918 paid during
14 the year 1919. The total amount of tax paid for the year 1918 during the year 1919 was $311.09. This overstatement of the unallowable deduction resulted in an overstatement of the net taxable income for the year 1919 in the revenue agent's report. This error in the amount of the taxable net income was not corrected by the Commissioner of Internal Revenue in his determination of the deficiency.

(h) The amount of depletion allowed as a deduction by the Commissioner of Internal Revenue for the calendar years 1917, 1918, and 1919 was erroneously computed on the basis of the cost of the development of the lease subsequent to the acquisition of the same by the petitioner. The fair market value of the development on the lease, amounting to $8,538.00 when acquired, was a part of the assets received in exchange for the capital stock, bonds and note of the petitioner and is subject to depletion. No depletion on the cost of this development has been allowed by the Commissioner of Internal Revenue. The amounts of depletion sustained and allowable as a deduction during the calendar years 1917, 1918, and 1919, as shown by a Form "O" and engineers appraisal report on the property operated, exceeds the amounts allowable by the Commissioner of Internal Revenue as shown below:

Year	Amounts allowed by commissioner	Amounts sustained	Excess
1917	$659.41	$4,789.68	$4,130.27
1918	764.20	4,394.67	3,630.47
1919	1,251.29	6,169.62	4,918.33
Total	2,674.90	15,353.97	12,679.07

(5) The facts upon which the petitioner relies as the basis for this proceeding are as follows:

(a–1) Under the provisions of the enabling act approved June 16, 1906, upon admission of the State of Oklahoma to the Union, sections 16 and 36 in every township in Oklahoma Territory and all idemnity lands theretofore selected in lieu thereof were granted to the State of Oklahoma for the use and benefit of the common schools.

(a–2) The enabling act further provided that such sections
15 16 and 36 and the lands taken in lieu thereof which were granted for the support of the common schools, if sold, should be appraised and sold at public sale. The proceeds were to constitute a permanent school fund, interest on which only should be expended in support of such schools. But said lands might, under such regulations as the legislature prescribed, be leased for a period not to exceed ten years and such lands should be reserved for school purposes only.

(a–3) However, the above provisions were subject to the following limitations:

Where any part of the lands granted by this act to the State of Oklahoma were valuable for minerals, gas or oil, such lands should not be sold by the said State prior to January 1, 1915, but the same might be leased for a period not to exceed five years by the State officers duly authorized for that purpose, and all proceeds from leases should be covered to the fund to which they should properly belong and no transfer or assignment of any lease should be valid or confer any right in the assignee without the consent of the proper authorities in writing.

(a–4) Section 16, township 21 north, range 8 east, Pawnee County, State of Oklahoma, was included in the lands granted to the State of Oklahoma under the provision of the enabling act as set forth above, and the part of said section 16 included in the lease from the State of Oklahoma to the petitioner was still owned and held by the State for the use and benefit of the common schools during the years 1917, 1918, and 1919.

(a–5) The lease for oil and gas purposes on the S. ½ of the NW. ¼; SW. ¼, NE. ¼, S. ½ of the SE. ¼ of section 16, township 21 north, range 8 east, Pawnee County, State of Oklahoma, between the petitioner and the State of Oklahoma was made in accordance with the terms and conditions of the enabling act and the statutes of the State of Oklahoma.

(a–6) The State of Oklahoma through its school land commissioners employed the petitioner to develop the leased premises for oil and gas. The lease specified a fixed royalty determined, as the law provided, by the commissioners of the land office and stipulated that the lessee should have and receive the balance of any production as compensation for its risk, services, and outlay in connection with such development and operations.

16 (a–7) The petitioner executed to the State, as required by law, a good and sufficient bond for the faithful performance of such lease. The lease was subject to forfeiture for breach of conditions, and could not be assigned or transferred without the consent in writing of the commissioners of the land office.

(a–8) The total net income or profits of the petitioner for the calendar years 1917, 1918, and 1919 was derived from the sale or disposition of its share of the oil and gas received under its lease on the S. ½ of the NW. ¼; SW. ¼ NE. ¼, S. ½ of the SE. ¼ of section 16, township 21 north, range 8 east, Pawnee County, State of Oklahoma.

(a–9) The petitioner had not income from any source other than the lease on the above described lands during the years 1917, 1918, and 1919.

(a–10) The amount of the net income of the petitioner from this lease, as determined by the Commissioner of Internal Revenue and

set forth in his deficiency letter dated November 13, 1925, for each of the years in question was as follows:

Year	Amount
1917	$15,949.09
1918	22,413.94
1919	13,500.88

(b–1) For several years prior to January 17, 1914, the Southwestern Oil Fields Company held an oil and gas lease on certain school lands belonging to the State of Oklahoma and described as follows:

Northeast quarter, south half of the northwest quarter, the southwest quarter and the south half of the southeast quarter, all in section 16, township 21 north, range 8 east of the Indian meridian, containing 480 acres.

This lease was a term lease and was to expire January 17, 1914. Under the terms of the lease the lessee had the preference right to release the property at the highest and best bid received for the next term of five years. The lease also provided that the physical equipment placed on the lease by the lessee and used in the operation thereon should be appraised at its fair market value by
17 the State, such appraised value to be the sales price of such equipment to the successful bidder in case the lessee failed to exercise its preference right to release the property. The terms of the lease provided that no expense incurred in drilling wells should be considered improvements or included in the appraised value thereof.

(b–2) At a meeting of the commissioners of the land office of the State of Oklahoma on September 18, 1913, Frank Orr was selected and designated on behalf of the State to appraise the improvements on the above described property.

(b–3) At a meeting the said commissioners of the land office on December 4, 1913, there was issued a notice of receiving bids for leasing the property described in paragraph (b–1) for oil and gas purposes. Among other things the notice of receiving bids provided as follows:

Said lands to be leased for oil and gas purposes is for a term of five years, with the preference right to release for an additional period of five years, at a royalty of 50% of the total output of all oil and gas from said lands and in addition there to such bonus as may be offered. All bids must be on forms provided and filed on January 9, 1914, and each bid must be accompanied by a certified check for $3,000.00 as earnest money. Each bidder shall deposit the sum of $55,800.00 in cash or bank draft drawn by some bank in the State of Oklahoma, payable to the commissioners of the land office of the State of Oklahoma for the improvements located on said land and now used in connection with the oil and gas wells being operated by the Southwestern Oil Fields Company, said improvements having been appraised and the value of same having been fixed in the above amount. Said sum of money so deposited

by the successful bidder to be paid over to said Southwestern Oil Fields Company in the event it elects not to exercise its preference right.

(b–4) In addition to the provisions set forth in the notice of receiving bids, the rules and regulations of the commissioners of the land office provided as follows:

The highest responsible bidder will be required to give bond
18 for the faithful performance of his contract and to develop the lands sufficiently to extract all the oil and gas thereunder with the least possible delay.

(b–5) On January 9, 1914, Geo. W. Sutton, acting for himself and three other individuals, namely, J. B. Myers, R. L. Lunsford, and John R. Williams, all of Cleveland, Oklahoma, filed a bid with the commissioners of the land office for the lease for oil and gas purposes on the land described in paragraph b–1 above. This bid was filed in answer to the notice of receiving bids mentioned above and offered to pay the royalty of 50% of all the oil and gas recovered with no bonus.

(b–6) On the same day the Southwestern Oil Fields Company filed a bid with the commissioners of the land office for the lease for oil and gas purposes on this same land offering to pay a royalty of 12½% of all the oil and gas recovered together with a cash bonus of $15,000.00. No other bids were filed.

(b–7) After considering the two bids received, at the meeting of the commissioners of the land office held January 12, 1914, it was moved and seconded that Geo. W. Sutton be declared the highest responsible bidder and that his bid be declared the highest and best bid received and that he be awarded a lease upon the above described land provided that if the Southwestern Oil Fields Company in the exercise of its preference right takes the lease at the high bid so received, then in that event a lease be awarded to said company for a second period of five years. The motion prevailed.

(b–8) At the meeting of the commissioners of the land office held January 19, 1914, the secretary reported that the Southwestern Oil Fields Company, in the exercise of their preference right, elected not to take a lease on the above described lands for the second period of five years upon the award recently made to Geo. W. Sutton. Thereupon, after possession of the lease and equipment had been delivered to Mr. Sutton, the amount of $55,800.00 deposited by him was paid over to the said Southwestern Oil Field Company. The chairman and secretary were authorized and directed to enter into a lease contract with Geo. W. Sutton for a term of five years and that his bond be fixed at $10,000.00, same to be a surety bond.

19 (b–9) At the meeting referred to in paragraph (b–8) above, after the officers had been directed to enter into the lease contract with him, the said Geo. W. Sutton requested that the lease awarded to him on the NE. ¼, S. ½ of NW. ¼, SW. ¼, and S. ½ of SE. ¼ be made to the Coronado Oil and Gas Company. After proper action this request was granted.

(b–10) On January 20, 1914, Geo. W. Sutton, J. B. Myers, and George Reynolds, all of Cleveland, Oklahoma, prepared and signed the articles of incorporation of the Coronado Oil & Gas Company. This document was forwarded to the secretary of state of Oklahoma and received by his office on January 21, 1914. On the same date the charter of the said Coronado Oil & Gas Company was issued.

(b–11) On or about February 2, 1914, the total authorized capital stock of the Coronado Oil & Gas Company, consisting of 250 shares, par value $100.00 each. Bonds of the par value of $25,000.00 and a note for the amount of $5,800.00 were issued by the corporation in full payment for the lease, the development on same and the equipment taken over from the Southwestern Oil Fields Company.

(b–12) The fair market value of the capital stock of the Coronado Oil and Gas Company at the time it was issued amounted to $83,538.00, which amount was determined as follows:

1. Fair market value of the equipment on the lease at the time same was acquired by the corporation, amounting to	$55,800.00
2. Fair market value of the development on the lease at the time same was acquired by the corporation, amounting to	58,538.00
Total	114,338.00
3. Deduct fair market value of bonds and note issued in part payment for assets	30,800.00
Fair market value of capital stock issued	83,538.00

(b–13) By a resolution passed by the commissioners of the
20 land office at a meeting held February 24, 1916, the expense of drilling wells on school lands was recognized as an additional value received by the successful bidder for a lease previously operated, and for this reason amended the rules and regulations, providing for an appraisal of the improvements on the lease, to include in the appraised value of such improvements, a fair, just, and reasonable compensation for the cost and expense of drilling each well then producing oil or gas in paying quantities and of each incompleted well on the lease at the time of such appraisal.

(b–14) On January 17, 1917, the petitioner and the commissioners of the land office entered into a supplemental agreement relative to the oil and gas lease on the land described in paragraph (b–1) above. This supplemental agreement provided that the royalty rate on all wells drilled on this property by the petitioner subsequent to this agreement should be 12½% of all the oil and gas produced therefrom instead of the 50% called for in the original lease.

(c–1) The revenue agent's report dated April 22, 1921, covering an examination of the books and records of the petitioner for the calendar years 1917, 1918, and 1919, on which the Commissioner of Internal Revenue bases his determination, shows the total tax assessable for the year 1917 to be the amount of $6,733.96. In adjusting the invested capital for the calendar year 1918, this amount was prorated for 200 days giving the adjusted average of $3,689.84. In schedule 2 for the year 1918 of the statement attached to the defi-

ciency notice the Commissioner of Internal Revenue increased the invested capital for the year 1918 as shown by the revenue agent's report by the amount of $130.62 with the explanation of "Difference in prorating 1917 income tax." This leaves the net amount deducted in the deficiency notice for 1917 taxes prorated amount to $3,559.22.

(c–2) If it is held that the income from this source is taxable then the correct amount of total tax assessable for the year 1917 is $1,110.81 which amount prorated for 200 days gives $608.66 for the adjusted average to be deducted from the invested capital as of the beginning of the year 1918.

(d–1) In computing the invested capital for the calendar year 1918 the Commissioner of Internal Revenue deducted
21 from the invested capital as shown by the revenue agent's report, the amount of $1,336.99 with the explanation "dividend paid November 4, 1918, prorated." A further explanation of this item was made in the 60-day letter which is as follows:

"Dividend of $20,000.00 paid November 4, 1918, prorated out of invested capital, after applying thereto the available earnings to date of payment less tentative tax."

(d–2) The correct amount to be deducted from the invested capital as of the beginning of the year for the dividend paid November 4, 1918, in excess of earnings available on that date is $648.05.

(d–3) The deduction of the amount of the tentative tax from the earning available for distribution is unwarranted under the law.

(e–1) The revenue agent's report, referred to in paragraph (c–1) above, shows the total tax assessable for the year 1918 to be the amount of $8,885.44. In adjusting the invested capital for the year 1919, this amount was prorated 154¼ days giving the adjusted average of $3,755.01. In schedule 2 for the year 1919 of the statement attached to the deficiency notice, the Commissioner of Internal Revenue increased the invested capital for the year 1919, as shown by the said revenue agent's report, by the amount of $104.96, with the explanation of "difference in prorating 1918 Federal income and excess-profits taxes." This leaves the net amount deducted in the deficiency notice for 1918 taxes prorated amount to $3,650.55.

(e–2) If it is held that this income is taxable then the co[illegible]amount of the total tax assessable for the year 1918 is $6,180.85, w[illegible]amount prorated for 154¼ days gives $2,612.04 for the adjusted average to be deducted from the invested capital as of the beginning of the year 1919.

(f–1) On or about March 15, 1919, the petitioner filed a tentative return for the calendar year 1918, and paid $311.09, being one-fourth of the estimated tax shown thereon, thereby securing an extension of time within which to file the completed return for the year 1918. On or before the final date of such extension, the petitioner filed its completed return for the calendar year 1918, the tax assessed
22 thereon amounting to $238.48, making an overpayment of $72.61 for the year 1918.

(f–2) As shown by the records of the office of the collector of internal revenue for the district of Oklahoma, the excess item of $72.61 was reported for refund on Form 751 for the month of March, 1921. (See page 116 of March 751.) Item was disallowed on Form 751 and has never been refunded.

(g–1) On page 13 of the revenue agent's report referred to in paragraph (c–1) above, in the reconciliation of net book profit with taxable net income-year 1919, the amount of $489.59 is shown as U. S. income tax paid. Also on page 12 of the said revenue agent's report in the computation of the additional tax liability for the year 1918, this amount of $489.59 is shown as the amount of tax previously paid for that year. This is an overstatement of the tax paid for the year 1918 by the amount of $178.50, as the amount of tax paid for the year 1918 was $311.09, as stated in paragraph (f–1) above. This overstatement of an unallowable deduction in the computation of net taxable income for the year 1919 results in an overstatement of the income claimed to be taxable by the amount of $178.50.

(h–1) The amount of depletion allowed by the Commissioner of Internal Revenue for the years 1917, 1918, and 1919 was computed on the cost of additional development placed on this property by the petitioner after its acquisition of same in January, 1914.

(h–2) There were 17 producing wells on this property when acquired by the petitioner, the fair market value of which wells amounted to $58,538.00 when acquired as set forth herein under paragraphs (b–1) to (b–14), inclusive.

(h–3) This fair market value amounting to $58,538.00 is subject to depletion, and the depletion computed on this basis is an allowable deduction from gross income for the years 1917, 1918, and 1919.

(h–4) The amount of depletion sustained and allowable as a deduction as shown by the Form O and engineer's appraisal report on this property is as follows:

23

Year	Amount
1917	$4,789.68
1918	4,394.67
1919	6,169.62
Total	15,353.97

(6) Wherefore the petitioner prays:

(a) That a copy of this amended petition be served upon the respondent and that he be required to appear and make answer hereto.

(b) That the board determine that the income received by the petitioner, during the calendar years 1917, 1918, and 1919, from school lands owned by the State of Oklahoma and leased for oil and gas purposes is exempt from taxation by the United States.

(c) That the board determine that the fair market value of the assets received by the petitioner in exchange for its capital stock exceeded the par value of said capital stock by the amount of $58,538.00 and that this excess value constituted a paid-in surplus.

(d) That the board determine that this paid-in surplus amounting to $58,538.00 should be included in the computation of the invested capital of the petitioner for the calendar years 1917, 1918, and 1919.

(e) That the board determine that, if the income received by the petitioner during the year 1917 is held to be taxable, the correct amount of the 1917 tax prorated to be deducted from the invested capital as of the beginning of the year 1918 is the amount of $608.66.

(f) That the board determine that the amount of a tentative tax should not be deducted from the earnings available for distribution on the date of the dividend payment.

(g) That the board determine that the amount of the divided paid from capital on November 4, 1918, prorated for the remainder of the calendar year 1918, amounts to $648.05.

(h) That the board determine that, if the income received by the petitioner during the year 1918 is held to be taxable, the correct amount of the 1918 tax prorated to be deducted from invested capital as of the beginning of the year 1919 is the amount of $2,612.04.

24 (i) That the board determine that the amount of Federal income and profits tax for the year 1918 paid by the petitioner during the year 1919 was $311.09 and that no part of this amount has been refunded to the petitioner.

(j) That the board determine that the petitioner is entitled to credit for tax previously paid amounting to $311.09 to be applied against the correct tax liability for the year 1918 as finally determined.

(k) That the board determine that the amount of depletion sustained and allowable as a deduction from gross income for the calendar years 1917, 1918, and 1919 should be computed on the basis of the fair market value of the development on the lease when acquired plus cost of additional development placed thereon by the petitioner plus amount of bonus paid for lease for second period.

(l) That the board determine that the amount of depletion sustained and allowable as a deduction from gross income for the calendar years 1917, 1918, and 1919 to be the amounts shown below or such other amounts as the facts may warrant:

Year	Amount
1917	$4,789.68
1918	4,394.67
1919	6,169.62
Total	15,353.97

(m) For such other and further relief as the nature of the case may require.

HUBERT L. BOLEN,
Counsel for Petitioner, 621 Tradesman's Nat'l Bank Building, Oklahoma City, Okla.

[*Duly sworn to by R. L. Lunsford, jurat omitted in printing.*]

25 [Exhibit "A" to amended petition omitted. Printed side page. 8–A ante.]

26 Before United States Board of Tax Appeals

[Title omitted.]

Answer to amended petition

(Excerpt from transcript of hearing Feb. 3, 1927)

Mr. DWIGHT H. GREEN. If your honor pleases, this case does not stand at issue at the present time. The situation is this: An amended petition has been filed by the petitioner and no answer has ever been entered by the commissioner and I ask leave at this time to enter a general denial for the commissioner to the allegations of fact set forth in the amended petition.

Mr. GREEN. I take it there is no objection to that?

27 Mr. BOLEN. None whatever.

Mr. GREEN. Very well. The commissioner's answer by way of general denial will be treated as having been made in the record.

Now, December 9, 1929, the foregoing answer to amended petition certified from the record as a true copy.

[Seal U. S. Board of Tax Appeals.]

B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

A true copy. Teste.

B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

Docket No. 10503

CORONADO OIL & GAS CO., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Promulgated January 14, 1929

Income—Lease—Exemption—Government instrumentality.—Petitioner's income derived from the sale of oil and gas produced by it from school lands owned by the State of Oklahoma and leased

by petitioner for oil and gas purposes. Held, not exempt from Federal income and profits taxes as, under the facts proven, petitioner is not shown to be such an instrumentality of the State of Oklahoma in its performance of a governmental function, that a tax upon its income constitutes an interference with the exercise by that State of a sovereign power.

Invested capital.—Upon the evidence, held, petitioner is entitled to include in invested capital $58,538 as a paid-in surplus, and further, that it is entitled to depletion upon that additional capital asset.

Id.—Held, that respondent erred in reducing invested capital by a tentative tax.

28 T. P. Gore, Esq., Hubert L. Bolen, Esq., D. A. Richardson, Esq., and S. W. Hayes, Esq., for the petitioner.

Dwight H. Green, Esq., and Maxwell E. McDowell, Esq., for the respondent.

Findings of fact and opinion

In this proceeding the petitioner seeks a redetermination of its income and excess-profits taxes for the calendar years 1917, 1918, and 1919, for which years the respondent has determined deficiencies in the following amounts: $6,556.86, $8,637.08, and $3,040.25, respectively, making a total deficiency of $18,234.19.

The petitioner alleges that respondent erred (1) in determining that its entire net income for the calendar years under consideration was not exempt from Federal income and profits taxes, such income having been derived from the production and sale of oil and gas from school land owned by the State of Oklahoma and leased by petitioner for oil and gas purposes; and, further, if its income be subject to Federal taxation, that respondent erred (2) in not including in invested capital for the said years the amount of $58,538 as a paid-in surplus; (3) in computing the amount of depletion, allowable as a deduction, upon the basis of cost of development of the lease subsequent to the acquisition of the same by the petitioner, it being alleged that the fair market value of the development on the lease, amounting to $58,538 when acquired by the petitioner, was a part of the assets received and is subject to depletion; (4) in reducing the petitioner's invested capital in each of said years by the amount of income and excess-profits taxes payable within the taxable years upon the income of preceding taxable years; and (5) in reducing invested capital at the beginning of the year 1918 on account of a tentative tax computed and deducted from available earnings to date of dividend payment in that year.

Findings of fact

The petitioner is a corporation organized under the laws of the State of Oklahoma, with its principal office in Cleveland, in that

State, for the purpose of leasing, holding, and operating oil, gas, coal, and other mineral lands and to engage in any line of business connected therewith.

The petitioner's entire income is derived from the sale of oil and gas produced by it from certain school land owned by the State of Oklahoma and duly leased to petitioner.

As a preliminary to the admission of Oklahoma to statehood an act of Congress was passed enabling the people of Oklahoma to form a constitution, etc., which was approved June 16, 1906. Ch. 3335, vol. 34, part 1, U. S. Stat. p. 267.

The enabling act contains the following provisions:

SEC. 3, PAR. 5. That provisions shall be made for the establishment and maintenance of a system of public schools which shall be open to all the children of said State * * *.

SEC. 7. That upon the admission of the State into the Union, sections numbered sixteen and thirty-six, in every township in Oklahoma territory, and all indemnity lands heretofore selected in lieu thereof, are hereby granted to the State for the use and benefit of the common schools * * *.

SEC. 8. * * * (Grant of other lands for university, certain educational institutions, and public institutions and buildings.)

Where any part of the lands granted by this act to the State of Oklahoma are valuable for minerals, gas and oil, such lands shall not be sold by the said State prior to January first, nineteen hundred and fifteen; but the same may be leased for periods not exceeding five years by the State officers duly authorized for that purpose, such leasing to be made by public competition after not less than thirty days advertisement in the manner to be prescribed by law, and all such leasing shall be done under sealed bids and awarded to the highest responsible bidder. The leasing shall require and the advertisement shall specify in each case a fixed royalty to be paid by the successful bidder, in addition to any bonus offered for the lease, and all proceeds from leases shall be covered into the fund to which they shall properly belong, and no transfer or assignment of any lease shall be valid or confer any right in the assignee without the consent of the proper State authorities in writing: Provided, however, that agricultural lessees in possession of such lands shall be reimbursed by the mining lessees for all damage done to said agricultural lessees' interest therein by reason of such mining operations. The legislature of the State may prescribe additional legislation governing such leases not in conflict herewith.

SEC. 9. That said sections sixteen and thirty-six, and lands taken in lieu thereof, herein granted for the support of the public schools, if sold, may be appraised and sold at public sale * * * the proceeds to constitute a permanent school fund, the interest of which only shall be expended in the support of such schools. But said lands may, under such regulations as the legislature may prescribe, be leased for periods not to exceed ten years; * * *.

The State of Oklahoma accepted the terms and the conditions of the enabling act. The constitution of Oklahoma, art. 11, sec. 1, reads as follows:

The State hereby accepts all grants of land and donations of money made by the United States under the provisions of the enabling act, and any other acts of Congress, for the uses and purposes and upon the conditions, and under the limitations for which the same are granted or donated; and the faith of the State is hereby pledged to preserve such lands and moneys and all money derived from the sale of any of said lands as a sacred trust, and to keep the same for the uses and purposes for which they are granted.

Article VI, sec. 32 provides as follows:

The governor, secretary of state, State auditor, superintendent of public instruction, and the president of the board of agriculture, shall constitute the commissioners of land office, who shall have charge of the sale, rental, disposing, and managing of the school lands and other public lands of the State, and of the funds and proceeds derived therefrom, under rules and regulations prescribed by the legislature.

The Legislature of the State of Oklahoma enacted a law authorizing and providing for the disposition, by sale and lease, of
31 the State public lands in conformity with the provisions of the enabling act, together with other regulations pertaining thereto, and also, authorizing the commissioners of the land office to adopt and promulgate rules and regulations for carrying into effect the provisions of the act.

On December 4, 1913, pursuant to a resolution adopted by the commissioners of the land office of Oklahoma, notice was given that the commissioners of the land office would receive on the 9th day of January, 1914, bids for releasing for oil and gas purposes certain described public lands belonging to the State of Oklahoma. The said notice stated that the lease would be for a term of five years, with privilege to release for an additional five years as prescribed by law and regulation; that each bidder should deposit the sum of $55,800, the appraised value of the equipment placed upon said land and used by the Southwestern Oil Fields Company; that the said lands contained fifteen producing wells; and that the total oil production from said land from January 1 to November 1, 1913, was 81,138 barrels, or an average of 8,113 barrels per month for ten months. The said notice also contained other information, which is included in the following notice sent out by the commissioners of the land office:

Rules and regulations for leasing public lands for oil and gas purposes

Bids to be received on the following described lands:

NE. ¼ and S. ½ of NW. ¼, and SW. ¼, and S. ½ of SE. ¼, all in section 16, twp. 21 N., range 8 E., Indian meridian, containing 480 acres.

Rule 1. All bids must be on forms furnished by the commissioners of the land office, and must be filed with the secretary, at four o'clock p. m., on the 9th day of January, 1914, to be opened immediately thereafter.

Rule 2. All bidders will be required to deposit a certified check or bank draft on some bank within the State, for the sum of three thousand dollars ($3,000), payable to the commissioners of the land office to be held as earnest money as outlined in the advertisement.

Rule 3. The highest responsible bidder will be required to give bond, to be approved by the commissioners of the land office
32 for the faithful performance of his contract, and to develop the land sufficiently to extract all the oil and gas thereunder with the least possible delay.

Rule 4. The royalty shall be fifty per centum (50%) of the total output of oil and gas from said lands, and all bonuses must be offered in addition to the fixed royalty. Should bonus be offered in cash, the same must be paid to the commissioners at the time of the execution of the lease, and if in oil, the bidder must offer a definite and specific percentage of the gross production in addition to the fixed royalty of fifty per centum (50%) above set out.

Rule 5. All producing wells that are now or may hereafter be drilled on adjoining properties to be offset by corresponding wells on the lands to be leased under these rules.

Rule 6. Certified copies of pipe line runs, and all sales and shipments to be furnished monthly, or on demand.

Rule 7. Accurate and reliable information concerning wells and their operation and management to be furnished on demand to the commissioners of the land office, or any one authorized to act for them.

Rule 8. The lease to conform to and be interpreted and construed by the laws of the State of Oklahoma, and the rules of the commissioners of the land office.

Rule 9. The Southwestern Oil Fields Company, a corporation, by virtue of its lease heretofore held upon said lands, under the law, is entitled to the preference right to re-lease said lands at the maximum rate of rentals, royalties and bonuses that may be obtained therefor, said preference right to take at the highest and best bid to be exercised within five (5) days after the award by the commissioners of the land office.

(Signed) LEE CRUCE,
Governor and Chairman.

Attest:

(Signed) JNO. R. WILLIAMS,
Secretary.

Under the rules of the commissioners of the land office governing bids received, the lease on the above described land was awarded to G. W. Sutton, who deposited with his bid the amount of $55,800 to be paid to the former lessees for the physical equipment lo-

33 cated thereon and used in connection with the operation of the fifteen producing wells thereon. The amount of $55,800 was the fair market value of the physical equipment as appraised by Frank Orr, duly appointed by the commissioners on September 13, 1913, to appraise such equipment, and was accepted by the prior lessees as full compensation at the time of the surrender of their prior lease. That amount did not include any value for the development of the leased property consisting of the drilling of seventeen wells.

Under the rules and regulations of the commissioners, governing the bidding for oil and gas leases on state school lands and the awarding of such leases which were in effect at the time this lease was awarded, there was no provision for appraising the cost of drilling the producing wells on leases to be advertised for re-leasing and including such appraised value in the amount to be paid by the successful bidder to the preceding lessee.

The reproduction cost of the producing wells, having an aggregate depth of 29,269 feet at the date of acquisition, was $2 per foot, or $58,538, and the estimated amount of oil to be produced from these wells over a five-year period or the duration of the lease was 76,000 barrels of oil for the lessee's 50 per cent share during the five years. The prevailing price of oil at the date of acquisition of the lease was $1.03 per barrel, representing an expected gross return of $78,280 and a present net worth to the lessee of $58,710 after deducting lifting cost and deferment in the amount of 25 per cent.

At the time that G. W. Sutton's successful bid was accepted on January 19, 1914, by the commissioners of the land office, the petitioner was not in existence. At the request of G. W. Sutton, the commissioners of the land office voted that the lease awarded to Sutton be issued to the Coronado Oil & Gas Company, whose charter was issued on January 21, 1914. The lease was duly executed, naming petitioner as lessee and being effective from January 17, 1914. G. W. Sutton and his associates, in exchange for their rights in the lease and the physical equipment on the land, received from the petitioner its note for $5,800, bonds of the petitioner in the amount of $25,000, and 250 shares of the petitioner's stock, par
34 value $100 each. The lease entered into by the commissioners of the land office and the petitioner reads as follows:

This indenture of lease, made and entered into in duplicate on this the 17th day of January, 1914, by and between the commissioners of the land office of the State of Oklahoma, hereinafter styled the lessors, parties of the first part, and Coronado Oil & Gas Company, hereinafter styled the lessee, party of the second part,

Witnesseth: That under and in pursuance of the constitution and laws of the State of Oklahoma, the said lessors, for and in consideration of the royalty, covenants, and stipulations and conditions herein expressed and hereby agreed to be paid, observed and performed by the said lessee, its successors and assigns, do hereby lease and let unto the said lessee and its successors and assigns for a term of five

(5) years from and after the date hereof all oil deposits and natural gas in or under the following described tract of land lying in the county of Pawnee, in the State of Oklahoma, to-wit:

The south half of the northwest quarter, the southwest quarter, the northeast quarter and the south half of the southeast quarter of section sixteen (16), township twenty-one (21) north, range eight (8) east I. M.

Which said lands are public lands belonging to the State, and were by the said commissioners of the land office declared to be valuable for oil and gas purposes, and the said oil and gas deposits therein contained were by the said commissioners of the land office segregated from the surface use and interest therein, with the right to prospect for, extract, pipe, store, refine and remove such oil and natural gas, with the right to use and keep so much of the said surface of said premises as may be necessary to prospect for, extract, pipe, store, refine, and remove such oil and natural gas, including still further the right to use a sufficient amount of such oil and natural gas as fuel, light and power so far as may be necessary to the prosecution of said operations, and with the further right to use any water on said premises that may be necessary to carry on said operations, in consideration whereof the lessee hereby agrees to pay a royalty of fifty (50%) per centum of all the oil and gas produced and sold from the fifteen wells now in operation upon the said premises, and to operate the same to their full capacity, and not to abandon or plug any well now upon the said lands without written consent of the commissioners of the land office first obtained in writing.

All oil and gas due to the State under this contract shall be delivered by the lessee herein or his assigns free of cost to the State into pipe lines, tanks, or cars, or settled for before removing the same from the premises if sold in any other way. Certified copies of gauge tickets, sales, and shipments to be furnished at the request of the commissioners or any one authorized to act for them; gas to be metered on the premises under high pressure unless some other method of gauging and measuring same shall be hereafter agreed upon in writing.

The lessee further covenants and agrees to exercise diligence in the sinking of wells for oil and gas purposes on the lands covered by this lease, and to drill a sufficient number of wells on said premises to offset each and every well drilled upon adjoining premises, and the said lessee is hereby required and binds itself to develop said premises as is required by the laws of the State of Oklahoma and the rules and regulations adopted by the commissioners of the land office.

Whenever any well shall hereafter be drilled adjoining said premises and such well shall produce oil or gas in paying quantities, then within fifteen days thereafter the lessee herein shall begin the drilling of offset wells as above provided and development of oil and

gas on such land herein shall be sufficient to extract all oil and gas therefrom with the least possible delay.

The said lessee shall operate the leased premises for oil and gas to as full an extent as individual and corporate premises are being operated within the general oil and gas field where such lands are located, and the failure to do so shall forfeit this lease to the State, and thereupon the commissioners of the land office shall be entitled to take immediate possession of said lands and all improvements thereon. Accurate and reliable information concerning all wells and their operation and management to be furnished on demand of
36 the commissioners of the land office. The said party of the second part further agrees to carry on operations in a workmanlike manner to the fullest possible extent; to commit no avoidable waste on the said land, and to suffer no avoidable waste to be committed upon the portion of its occupancy or use; to take good care of the same, and to promptly surrender and return the premises upon the termination of this lease.

The tools, boilers, power houses, lines, pumping and drilling outfits, tanks, engines and machinery (and casing of all dry and exhausted wells) shall remain the property of the party of the second part, and may be removed by them at any time before or at the expiration of this lease.

The casing, derricks, boilers, power houses, power plants, lines, tanks, tubing, rods, pumping and drilling outfits, engines and machinery, tools and all other appliances necessary to be used in the operation of any producing well on the lease, shall be appraised six months prior to the expiration of this lease contract, in order to ascertain the fair and reasonable value thereof by appraisers, one to be appointed by the commissioners of the land office, and one by the lessee herein named or its assignee holding said lease at the time, and if said appraisers be unable to agree upon the fair and reasonable value of all such property of the lessee or its assigns on said premises the two appraisers so appointed shall have the right and authority to appoint a third person, and the appraisement of a majority of said three appraisers shall be binding upon both parties hereto. It being expressly understood that the actual sale value of the materials and improvements mentioned at the time of appraisment shall alone be considered and no expense incurred in drilling, except materials permanently used in the operation of the well, shall be considered as improvements.

In advertising said land for release for a second term of five years, the appraised value of said property of the lessee on the lease shall be stated in said advertisement, and any bidder other than the lessee herein named or its assignee shall be required to deposit the appraised value thereof with the commissioners of the land office at the time the bid for the second term of five years is made, and
37 if the lessee herein named or its assignee does not succeed in leasing said premises for a second period of five years,

then in that event said amount shall be paid over to the lessee, herein named or its assignee, provided, however, that all royalties, rentals, charges, and claims have been paid; that it will not permit any nuisance to be maintained on the premises under its control; that it will not use such premises for any other purpose than those authorized in this lease. Said second party further obligates itself and agrees not to plug, abandon, or pull the casing from any well, productive or otherwise, without first securing the written consent of the first party, or its duly authorized agent, and it is further mutually agreed that a violation of this provision shall work a forfeiture of this lease at the option of the first party, and that before abandoning any well under said written consent it will securely plug the same so as to effectually shut off all water above and below the oil bearing horizons according to law.

And the said party of the second part further covenants and agrees that it will keep an accurate account of all oil and gas mining operations, showing the sales, prices, dates of purchase, and the whole amount of oil and gas mined and removed; and all sums due as royalties shall be a lien on all implements, tools, movable machinery and all other personal chattels used in said prospecting and mining operations and upon all the unsold oil obtained from the land herein leased as security for the payment of said royalty.

And it is mutually understood and agreed that this indenture of lease shall in all respects be subject to the rules and regulations heretofore or that may hereafter be lawfully prescribed and not in conflict with the lawful terms of this lease by said commissioners relative to oil and gas leases of public lands, and that this lease or any interest therein shall not be sublet, assigned or transferred without the consent of the commissioners of the land office first obtained in writing. And it is further mutually understood and agreed that this lease is not executed to or in the interest of any pipe line or transportation company, or any company allied to or confederated therewith or any subsidiary company thereof, nor any other
38 company, corporation, person or association under the control of either or all of them, nor to any stockholder, officer, director, agent, representative or employee, acting singly or as a firm, or corporation of such companies or either of them, and that should the second party or its assigns violate any of the covenants, stipulations or provisions of this lease, or any of the regulations, or fail for a period of sixty days to pay the stipulated royalties provided herein, then the commissioners, after ten days' notice to the parties hereto, shall have the right to avoid this indenture of lease and cancel the same.

If the lessee makes reasonable and bona fide efforts to find and produce oil in paying quantities as herein required of it, and such effort is unsuccessful, it may at any time thereafter surrender and wholly terminate this lease upon the full payment and performance of all its then accrued and payable obligations hereunder.

It is agreed that for any refinery of crude oil and its products and by-products owned and controlled by the State of Oklahoma the State shall have the preference right to purchase and receive the output from said premises at the market prices therefor; providing that the lessee may sell the said output to any firm, corporation or person whatsoever until notice in writing from the commissioners of the land office has been served upon the lessee that the State of Oklahoma is ready to take such oil or gas or either of them.

The lessee, its successors, or assigns, shall have the preference right to re-lease said premises for a second term of five years at the expiration of this lease, at the maximum rate of rentals, royalties, and bonuses that may be obtained therefor at the time of such renewal. Said maximum rate shall be determined by such reasonable and lawful regulations as are now or may hereafter be prescribed by the commissioners of the land office or other persons or persons authorized thereto by the State of Oklahoma.

The term "Commisisoners of the land office of the State" as used in this lease shall include any board, person, or persons who are or may hereafter be authorized by law to act in behalf of the State in the matters relating to the leasing of the public lands of the State of Oklahoma for oil and gas purposes.

89. It is further agreed and understood that the approval of this lease by the commissioners shall be of no force nor effect unless the party of the second part furnish a bond in the sum of ten thousand dollars ($10,000.00) to the satisfaction of said commissioners, in accordance with the regulations of said commissioners, which shall be deposited and remain on file in the office of the commissioners of the land office of Oklahoma.

And it is agreed that the lessee shall, at the expiration of each quarter after the premises produce oil and gas, or either of them, make and file with said commissioners a production report showing the full amount of the production of oil and gas, or either of them, for the quarter prior to the said report, and whenever said production reports, computed together or singly vary from the sales report, the lessee, upon the proper showing and proof shall be given credit on the production report or reports for the amount of shrinkage.

The said lessee binds and obligates itself to do and perform all of the conditions imposed on it by law and this lease and obligates itself to protect the State of Oklahoma from all damage, loss, charges, and claims of every kind or nature, by reason of a failure to comply in whole or in part with the terms of this lease, and in the event that lessee fails, neglects, or refuses to comply with the terms of this lease as herein imposed, this lease and all rights and privileges inuring to the benefit of the said lessee may be forfeited and cancelled, and the said commissioners for and on behalf of the State of Oklahoma shall be entitled to recover from the lessee's bondsmen all rents, royalties, charges, and claims of every kind and nature due and owing and accruing and arising out of and by reason of this lease.

In witness whereof, the said parties have hereunto subscribed their signatures, the day and year first above written.

THE COMMISSIONERS OF THE LAND OFFICE OF THE STATE OF OKLAHOMA,

(Signed) By LEE CRUCE,
Governor of the State of Oklahoma and Chairman of said Commissioners.

40 Attest:
[SEAL.]
JOHN R. WILLIAMS,
Secretary.

CORONADO OIL AND GAS COMPANY,

(Signed) By G. W. SUTTON, *President.*

Attest:

GEORGE REYNOLDS.

Under date of January 17, 1917, the commissioners of the land office and the petitioner entered into a supplemental agreement permitting petitioner to drill additional wells and to pay a royalty of 12½ per cent on oil and gas produced from such additional wells, but in nowise affecting the 50 per cent royalty on the oil from wells already drilled and producing. The primary purpose of that supplemental agreement was to enable petitioner to drill offset wells to prevent drainage of oil from the leased school land.

Upon the expiration of petitioner's lease in January, 1919, the lands covered by said lease were duly advertised for re-lease subject to the preference right of petitioner. At that time the regulation governing the determination of the sum to be paid the prior lessee by the succeeding lessee, had been changed so that the appraisal of property to be surrendered by the prior lessee included not only the fair value of the physical equipment on the land, but also the fair value of the improvements, namely, the drilled and producing wells. On March 18, 1919, the commissioners of the land office received all bids and awarded the lease to petitioner, effective as of the date of the expiration of its prior lease in January, 1919. The lease reads as follows:

This indenture of lease, made and entered into in duplicate, on this Jan. day of 17th A. D., 1919, by and between the commissioners of the land office of the State of Oklahoma, acting for and in behalf of the State of Oklahoma, parties of the first part, hereinafter designated as lessor, and Coronado Oil & Gas Company, of Cleve-
41 land, Oklahoma, party of the second part, hereinafter designated as lessee, under and in pursuance of the provisions of the constitution and laws of the State of Oklahoma, relating to the segregation of the oil and gas deposits and the leasing thereof on school and other public lands belonging to the State of Oklahoma, witnesseth:

1. The lessor, for and in consideration of four hundred and eighty No/100 ($480.00) dollars, the receipt whereof is hereby acknowl-

edged, and of the royalties, covenants, stipulations, and conditions hereinafter contained and hereby agreed to be paid, observed, and performed by the lessee, and his lawful assigns, does hereby demise, grant, lease, and let unto the lessee for the term of five years from the date hereof, and as long thereafter as oil or gas or either of them is produced in paying quantities, all the oil deposits and natural gas in or under the following described tract of land lying and being within the county of Pawnee, in the State of Oklahoma, to wit:

Northeast (NE. ¼) quarter; south-half of northwest (NW. ¼) quarter, south-half (S. ½) of the southeast (SE. ¼) quarter and the southwest (SW. ¼) quarter of section sixteen (16) township twenty-one (21) north range eight (8) E. I. M.

and containing 480 acres, more or less, with the exclusive right to prospect for, extract, pipe, store, and remove oil and natural gas, and to occupy and use so much only of the surface of said land as may reasonably be necessary to carry on the work of prospecting for, extracting, piping, storing, and removing such oil and natural gas. Also the right to obtain from wells or other sources on said land by means of pipe lines or otherwise, a sufficient supply of water to carry on said operations, except the private wells or ponds of the surface owner or lessee, and also the right to use, free of cost, oil, and natural gas as fuel so far as necessary to the development and operation of said property.

2. The lessee hereby agrees to deliver or cause to be delivered to the commissioners of the land office of the State of Oklahoma, or their successors, a royalty, of one-eighth part of the oil or gas
42 produced from the leased premises or in lieu thereof pay to the State the market value of said royalty interest, as the commissioners may elect. All oil and gas due to the State under this contract, shall be delivered by the lessee herein, free of cost, into pipe lines, tanks, or cars, or settled or paid for before removing same from the premises if handled in any other way. The lessee shall furnish to the lessor certified copies of gauge tickets, sales, shipments, and amount of gross production, at their office in Oklahoma City. Gas to be metered on the premises under high pressure, unless some other method of gauging and metering same shall be hereafter agreed upon by the parties hereto in writing.

3. The lessee shall exercise diligence in sinking wells for oil and natural gas on the land covered by this lease, and shall drill a sufficient number of wells to offset the wells upon adjoining contiguous premises, said offset wells to be commenced within 10 days after completion of any producing well upon such adjoining contiguous premises, unless a different time is prescribed by notice in writing from the lessor, and be prosecuted diligently and continuously until completed; and the said lessee shall operate the leased premises for oil and gas to same extent as individual and corporate premises are being operated within the general oil and gas fields where such land is located, and failure to faithfully comply with this provision shall be cause for forfeiture of this lease to the State.

At least one well, producing oil or gas in paying quantities, shall be drilled and completed within one year from the date hereof, or failing so to do the lessee shall pay to the lessor for each whole year the completion of such well is delayed, for not to exceed five years from the date hereof, in addition to the other consideration named herein, a rental of one ($1.00) dollar per acre, payable annually, in advance, and if the lessee shall fail to drill at least one such well within any such yearly period, and shall fail to surrender this lease on or before the end of any such year during which the completion of such well is delayed, such failure shall be taken as conclusively evidencing the election and covenant of the lessee to pay the rental of one ($1.00) dollar per acre for such year, and thereupon the lessee shall be absolutely obligated to pay such rental. The failure of the lessee to pay such rental before the expiration of fifteen
43 (15) days after it becomes due at the end of any yearly period during which a well has not been completed as herein provided shall be a violation of one of the material and substantial terms and conditions of this lease, and be cause for cancellation thereof, but such cancellation shall not in any wise operate to release or relieve the lessee from the covenants and obligations to pay such rental or any other accrued obligation. It being understood that the completion of one well, producing oil or gas in paying quantities during the life of this lease, shall relieve the lessee of all future liability for said $1.00 per acre hereunder, but the lessee shall nevertheless remain obligated to drill an offset, or necessary offsets, and other wells necessary to the proper development and operation of said lease as herein otherwise provided; and provided further that unless a producing well of oil or gas is completed on the above described premises within five years from date hereof this lease shall be void.

4. The lessee shall carry on the development and operation in a workmanlike manner; commit no waste on said land, and suffer none to be committed upon the portion in his occupancy or use; taken good care of the same, and promptly surrender and return the premises upon the termination of this lease to the lessor, or to whomsoever shall be lawfully entitled thereto, unavoidable casualty only excepted.

All tools, derricks, boilers, boiler houses, pipe lines, pumping and drilling outfits, tanks, engines and machinery, and the casing of all dry or exhausted wells shall remain the property of the lessee, and may be removed at any time prior to or at the termination of the lease by forfeiture or otherwise; and the lessee shall not permit any nuisance to be maintained on the premises; and shall not use said premises for any purposes than those authorized in the lease; and before abandoning any well, shall securely plug the same so as to effectually shut off all water from the oil bearing stratum, or in the manner required by the laws of the State of Oklahoma.

5. The lessee shall keep an accurate account of all oil and gas mining operations, including a log of each well drilled, duly sworn to by the contractor or driller, which shall be filed with the

secretary to the commissioners of the land office within thirty days after said well is completed. Accurate and reliable information concerning all wells and their operation and management shall be furnished to the commissioners of the land office or their representatives upon demand. The said lessee shall also keep an accurate account showing the sales, prices, dates, purchases, and the whole amount of oil and gas mined or removed, and all sums due as royalties shall be a lien on the implements, tools, and movable machinery or personal chattels used in operating said property, and also upon all the unsold oil and gas obtained from the land herein leased as security for the payment of said royalties.

6. The lessee shall be liable to the surface owner or surface lessee for all damages or loss accruing to the surface interests in said land, and to all crops and improvements thereupon and appurtenances and hereditaments thereunto belonging by reason of the oil or gas mining operations hereunder, and in the event the amount of such damage can not be agreed upon by the lessee hereof and such surface owner or lessee, then the amount of such damage shall be determined as is or may be provided by law. The lessee hereof further agrees to pay all such damages within ten days after the amount thereof is determined, and the amount of such damages may be recovered from the lessee hereof and his sureties upon the bond given to secure the faithful performance of this lease.

7. This lease shall be subject to the constitution and laws of the State of Oklahoma and the rules and regulations of the commissioners of the land office now or hereafter in force relative to such leases; all of which are made a part and condition of this lease: Provided, That no regulations made after the execution of this lease affecting either the length of the term hereof, the rate of royalty, or payment hereunder or the assignment hereof, shall operate to affect the terms and conditions of this lease.

8. No transfer or assignment of this lease, or any part thereof, shall be valid or convey any right in the assignee without the consent in writing of the commissioners of the land office; and such assignee shall furnish a bond to the satisfaction of the commissioners of the land office, conditioned for the faithful performance of the covenants and conditions of this lease, and pay an assignment fee of five dollars.

9. Before this lease shall be in force and effect the lessee shall give a good and sufficient bond in the sum of two thousand & no/100 ($2,000.00) dollars, to be approved by the commissioners of the land office, for the faithful performance of this lease.

10. Upon the violation of any of the substantial terms or conditions of this lease, the commissioners of the land office shall have the right at any time after hearing upon ten days' notice, given by registered mail to the last known address of such lessee, or by posting notice in writing in a conspicuous place upon the said premises, specifying the terms or conditions violated, to declare this lease null and void; and the said commissioners for and on behalf of the State

of Oklahoma, shall be entitled to recover from the lessee's bondsmen, all rents, royalties, charges, claims of every kind and nature due and owing and accruing and arising out of and by reason of this lease, on failure to comply with the provisions thereof, and the lessors shall be be entitled and authorized to take immediate possession of the land.

11. It is further agreed that for any refinery of crude oil and its products and by-products, owned and controlled by the State of Oklahoma, the State shall have the preference right to purchase and receive the output from said premises at the market price thereof; provided, that this clause shall not prevent the lessee from selling the output of said leases to any person, firm or corporation whatsoever until notice in writing from the commissioners of the land office shall be served on the lessee that the State is ready to take such oil and gas or either of them, and all sales of oil and gas or either of them under this proviso shall be valid and binding.

12. The lessee may at any time hereafter surrender and wholly terminate this lease upon payment of the rentals and other liabilities then accrued and due hereunder, and may exercise such right by filing a formal relinquishment and release of the said lease with the secretary to the commissioners of the land office: Provided, that if such lease has been recorded, by causing the release thereof
46 to be filed and recorded in the proper recording office, and upon a compliance with these requirements such lessee shall thereby be relieved from liability for rental thereafter accruing.

13. The surface owner or lessee of the said premises shall have gas free of cost from any well on said premises for domestic use thereon by making his own connection with the well.

In witness whereof the parties hereunto subscribed their signatures on the day and year first above written.

THE COMMISSIONERS OF THE LAND OFFICE OF THE STATE OF OKLAHOMA,

(Signed) By J. B. A. ROBERTSON,
Governor and Chairman.

Attest:

(Signed) A. S. J. SHAW,
Secretary to the Commissioners of the Land Office.

CORONADO OIL & GAS COMPANY,
Lessee.

(Signed) By R. L. LUNSFORD,
President.

Attest:

(Signed) J. B. MYERS, *Treas.*

Petitioner's only source of income during the years under consideration was from the sale of oil and gas produced from the lands leased as aforesaid and respondent determined such income to be taxable.

Respondent excluded from petitioner's invested capital the amount of $58,538, which petitioner claims should be included therein as a paid-in surplus representing the value of the improvements and producing wells on the leased lands at the date of acquisition and respondent also excluded the said amount from the basis upon which he computed the allowed deductions for depletion.

In computing petitioner's invested capital for the year 1918, respondent reduced the same by the amount of $1,336.99 on
47 account of a dividend of $20,000 paid November 4, 1918, prorated out of invested capital after applying thereto the available earnings to date of payment less tentative tax.

Opinion

TRUSSELL: The taxes here involved are for the calendar years 1917, 1918, and 1919, and the deficiencies appealed from have been determined under the revenue acts of 1916, 1917, and 1918. By section 10 of the first mentioned act, which is carried into the two subsequent acts, a tax is imposed upon the net income of "every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized," with the exception of corporations operated for certain specified purposes, which need not be here detailed, as it is not claimed that petitioner falls within one of these excepted classes.

It is not questioned that petitioner is a private domestic corporation, created and operated for the personal and private gain of its individual stockholders, and that the property from which the income in question was derived, consisting of a lease of oil lands and physical assets represented by the operating equipment on those lands, belonged to it and represented the personal investment of its stockholders. It will thus be seen that petitioner is subject to tax upon its income unless entitled to some exemption, and that such exemption, if it exists, is not granted by the taxing statute.

Petitioner claims that its income during the taxable years in question is exempt from Federal taxation for the reason that it was all derived from the sale of oil and gas produced from public-school lands leased from the State of Oklahoma, that by its lease of such lands from the State it became the instrumentality through which the latter derived part of its public-school fund, and that to tax its income is to burden the State in the performance of its governmental function of maintaining public schools. In approaching the question we must bear in mind that exemption from tax is never presumed, but, on the other hand, the presumption is in favor of the taxing power, and the burden is upon the claimant to establish
48 clearly and beyond doubt its right to exemption. It is well recognized that "taxation is the rule and exemption the exception." Cooley on Taxation, vol. 1, p. 356.

The mere fact that the property of the State of Oklahoma is exempt from Federal taxation does not grant such immunity to a

lessee of that property, as it is well recognized that the right to use property is distinct from the fee and that a tax upon the interest of the lessee is not a tax upon that of the lessor. In Heiner v. Colonial Trust Co., 275 U. S. 232, the court held the lessee of tax-exempt Indian lands liable to Federal income tax upon the ground that the exemption of the lessor by Congress could not be presumed to extend to those doing business with him.

In Jetton v. University of the South, 208 U. S. 489, there was involved the right of the State to lay a tax upon the interest of a lessee in property belonging to a lessor who was specifically exempted from taxation by statute, it being claimed that the tax violated the legislative contract of the statute, as it lessened to that extent the value of the leasehold interest to the lessor and thus indirectly burdened him with the tax. In denying exemption to taxation to the lessee the court said:

As long as different interests may exist in the same land, we think it plain that an exemption granted to the owner of the land in fee does not extend to an exemption from taxation of an interest in the same land granted by an owner of the fee to another person as a lessee for a term of years. The two interests are totally distinct, and the exemption of the one from taxation plainly does not thereby exempt the other.

In Elder v. Wood, 208 U. S. 226, the right of the State of Colorado to tax a mining claim belonging to an individual was questioned, the fee in the land upon which the claim was located being in the United States. The court in sustaining the right to tax held that the property taxed was "the right of possession of the land for mining purposes," which belonged to the individual, saying:

Such an interest from early times has been held to be property, distinct from the land itself, vendible, inheritable and taxable.

That the State may not impose a tax which interferes with the free exercise by the Federal Government of the powers granted it by the Constitution, and that a privilege or occupation tax upon an instrumentality which represents, in its creation or use a direct exercise of such powers, is an interference therewith, can not be questioned.

In McCullough v. Maryland, 4 Wheat. 316, the right of the State was denied to impose a privilege or occupation tax upon the Bank of the United States, a corporation created by Congress, upon the ground that Congress possessed the power to create such a corporation and the grant of such power by the Constitution implied such immunity as necessary to maintain the free exercise thereof and accordingly the taxation by the State of the thing created, the corporate body, was an interference with the exercise of such power. Following this decision the courts in many decisions have affirmed and applied this rule. Osborn v. Bank, 9 Wheat. 738; Weston v. City Council of Charleston, 2 Pet. 449; Dobbins v. The Commissioners of Erie County, 16 Pet. 436; Van Allen v. Assessors, 3 Wall.

578; Bradley v. People, 4 Wall. 459; National Bank v. Commonwealth, 9 Wall. 353; Van Brocklin v. State of Tennessee, 117 U. S. 151; Northern Pacific R. R. Co. v. Smith, 171 U. S. 261; Grether v. Wright, 75 Fed. 742; Home Savings Bank v. Des Moines, 205 U. S. 503; Farmers' Bank v. Minnesota, 232 U. S. 516; Johnson v. Maryland, 254 U. S. 51.

The converse of this rule, a corresponding limitation upon the power of the Federal Government to interfere with the exercise by the States of the powers reserved to them, is equally well established.

In Collector v. Day, 11 Wall. 113, it was held that the Federal Government had no right to impose a tax upon the salary of an executive officer of a State, the court saying:

And if the means and instrumentalities employed by that government to carry into operation the powers granted to it are, necessarily, and, for the sake of self-preservation, exempt from taxation by the States, why are not those of the States depending upon their reserved powers, for like reasons, equally exempt from Federal taxation? Their unimpaired existence in the one case is as essential as in
50 the other. It is admitted that there is no express provision in the Constitution that prohibits the General Government from taxing the means and instrumentalities of the States, nor is there any prohibiting the States from taxing the means and instrumentalities of that Government. In both cases the exemption rests upon necessary implication, and is upheld by the great law of self-preservation; as any government, whose means employed in conducting its operations, if subject to the control of another and distinct government, can exist only at the mercy of that government.

In Pollock v. Farmers Loan & Trust Co., 157 U. S. 584, the court said:

As the States cannot tax the powers, the operations, or the property of the United States, nor the means which they employ to carry their powers into execution, so it has been held that the United States have no power under the Constitution to tax either the INSTRUMENTALITIES OR THE PROPERTY of a State.

In Ambrosini v. United States, 187 U. S. 1, the power of the Federal Government was denied to levy a stamp tax on bonds given a State under a requirement of its law. The court said:

The general principle is that as the means and instrumentalities employed by the General Government to carry into operation the powers granted to it are exempt from taxation by the States, so are those of the States exempt from taxation by the General Government.

The application of these rules has, however, been limited to those cases where the Federal Government or the State in its employment and use of an instrumentality was performing some definite governmental function peculiar to its sovereign character. It is held not to apply to the case where a private individual or corporation merely deals with the Federal Government, or with the State for private gain under a contract executed by the latter as an incident of the exercise of one of its governmental powers.

In Baltimore Shipbuilding Co. *v.* Baltimore, 195 U. S. 375, the Supreme Court, speaking through Justice Holmes, said: But, furthermore, it seems to us extravagant to say that an independent private corporation for gain, created by the State, is exempt from State taxation, either in its corporate person, or its property, because it is employed by the United States, even if the work for which it is employed is important and takes much of its time.

In Fidelity & Deposit Co. *v.* Pennsylvania, 240 U. S. 319, the corporation claimed immunity from taxation by the State on premiums collected by it on bonds executed under authority of an act of Congress allowing it to be accepted as surety on bonds required by laws of the United States, charging that its transactions with the Federal Government thereunder constituted it a governmental instrumentality. In holding that it was subject to taxation by the State on such business the court said:

But mere contracts between private corporations and the United States do not necessarily render the former essential governmental agencies and confer freedom from taxation.

In Osborn v. The Bank, supra, where it was held that the Bank of the United States was not a private corporation but a public one, created for national purposes and accordingly not subject to taxation by the State, Chief Justice Marshall, for the court, conceded that had it been a private corporation, with private trade and profit its purpose, it would be subject to State taxation. The learned Chief Justice said that had this been the case—

This mere private corporation engaged in its own business, with its own views, would certainly be subject to the taxing power of the State, as any individual would be; and the casual circumstance of its being employed by the government in the transaction of its fiscal affairs would no more exempt its private business from the operation of that power than it would the private business of any individual employed in the same manner.

In Flint *v.* Stone Tracy Co., 220 U. S. 108, the court, after citing the authorities holding that the State can not tax agencies
52 or corporations which are created for the purpose of carrying out governmental functions of the United States, said:

An examination of these cases will show that in each case where the tax was held invalid the decision rested upon the proposition that the corporation was created to carry into effect powers conferred upon the Federal Government in its sovereign capacity, and the attempted taxation was an interference with the effectual exercise of such powers.

In this case the court in its discussion of the right of the Federal Government to tax instrumentalities of the State said:

The true distinction is between the attempted taxation of those operations of the States essential to the execution of its Governmental functions, and which the State can only do itself, and those activities which are of a private character. The former, the United States may not interfere with by taxing the agencies of the State in

carrying out its purposes; the latter, although regulated by the State and exercising delegated authority, such as the right of eminent domain, are not removed from the field of legitimate Federal taxation.

And so in Grover *v.* Standard Dredging Co., 224 U. S. 362, it was held that the property of a contractor employed by the United States was not exempt from taxation even though exclusively used for the carrying out of the contract.

The Supreme Court has also drawn a definite distinction between those cases in which the State was exercising a purely governmental power and one merely incident, and equivalent to the carrying on of a private business, although the agency employed was one representing the interest of the State alone. In South Carolina *v.* United States, 199 U. S. 437, there was presented the right of the Federal Government to lay an excise tax upon the agents employed by the State of South Carolina to operate the State liquor dispensary under the provisions of a statute of that State under which it took over the exclusive sale of liquor, this statute having been held constitutional by the Supreme Court as a proper exercise of
53 its sovereign police power. In this case the business carried on by the agents was wholly an activity of the State itself, all of the net profits were revenue to the State and any burden by way of tax on the business was directly reflected in a lessening of the revenue it ultimately received. The court, after reviewing the authorities, in sustaining the right of the Federal Government to tax this instrumentality of the State said:

So here the charge is not upon the property of the State, but upon the means by which that property is acquired, and before it is acquired.

It is also worthy of remark that the cases in which the invalidity of a Federal tax has been affirmed were those in which the tax was attempted to be levied upon property belonging to the State, or one of its municipalities, or was a charge upon the means and instrumentalities employed by the State, in the discharge of its ordinary functions as a government.

Many cases have arisen calling for the application of the general rules discussed, and the courts have recognized that the question is not one in which a hard and fast rule may be laid down which may be applied to every case of attempted taxation of a State or Federal agency. The reason for this is that the question in each case is whether or not, under the particular facts involved, the tax constitutes an interference with the exercise of a sovereign power. The objection to it, in any case, rests not upon the fact that it is a tax but that it is an interference with the exercise of a power which is immune from interference. Even where the levying of the tax interferes with the exercise of a right possessed by the State, it may not constitute an interference with its necessary governmental powers. This is illustrated by the case of Veazie Bank v. Fenno, 8 Wall. 533. In this case the Federal Government levied a tax upon the circulation of a State bank, the question being practically the

converse of that involved in McCullough v. Maryland, supra. In sustaining the validity of the tax the Supreme Court admitted that the right to create such a bank was not surrendered by the State in the grant of power to the Federal Government by the Constitution, but such a power was not one of these necessary to be kept free from interference to maintain the sovereignty of the
54 State. The court in that case points out those functions of the State which are sovereign in the following words:

It may be admitted that the reserved rights of the States, such as the right to pass laws, to give effect to laws through executive action, to administer justice through the courts, and to employ all necessary agencies for legitimate purposes of State government, are not proper subjects of the taxing power of Congress. But it cannot be admitted that franchises granted by a State are necessarily exempt from taxation; for franchises are property, often very valuable and productive property; and when not conferred for the purpose of giving effect to some reserved power of a State, seem to be as properly objects of taxation as any other property.

And so it has been held that where the effect of the tax was merely to cause the Federal Government or the State to receive less income than it would had the tax not been imposed, it is not an interference with its sovereignty as a tax upon its property. In this connection it is noted that the courts have held proper a succession tax levied upon legacies of property to the Federal Government or the State, the effect of which tax was to lessen the amount ultimately received under the legacy. Thus, in United States v. Perkins, 163 U. S. 625, a succession tax of the State of New York was sustained, although the property charged was bequeathed by will to the United States, and in Snyder v. Bettman, 190 U. S. 249, a Federal succession tax was sustained although the bequest in question was to the city of Springfield, Ohio.

In Railroad v. Peniston, 18 Wall. 5, the court, in holding that a tax upon the property of a government instrumentality was not an interference with the exercise of the governmental power to do those things which it is carrying into effect through the agent, said:

It is therefore manifest that exemption of Federal agencies from State taxation is dependent not upon the nature of the agents or upon the mode of their constitution or upon the fact that they are agents, but upon the effect of the tax; that is, upon the question whether the tax does in truth deprive them of power to serve
55 the Government as they were intended to serve it, or does it hinder the efficient exercise of their power.

In Metcalf & Eddy v. Mitchell, 269 U. S. 515, the right of the United States was questioned to tax such portion of the incomes of two partners in an engineering firm as represented payments made the partnership by certain States and municipalities for services rendered as consulting engineers, it being claimed that as to the employment for which they were paid they were agents of the State governments and as such exempt from taxation. The court, after

reviewing the authorities, in restating the rule as announced in Railroad *v.* Peniston, supra, that the fact of whether or not the tax constituted an interference was one for determination under the facts of each case as submitted, said:

As cases arise, lying between the two extremes, it becomes necessary to draw the line which separates those activities having some relation to government, which are nevertheless subject to taxation, from those which are immune. Experience has shown that there is no formula by which that line may be plotted with precision in advance. But recourse may be had to the reason upon which the rule rests, and which must be the guiding principle to control its operation. Its origin was due to the essential requirement of our constitutional system that the Federal Government must exercise its authority within the territorial limits of the States; and it rests on the conviction that each government, in order that it may administer its affairs within its own sphere, must be left free from undue interference by the other. McCulloch *v.* Maryland, supra; Collector *v.* Day; Dobbins *v.* Commisisoner or Erie County, supra.

In a broad sense, the taxing power of either government, even when exercised in a manner admittedly necessary and proper, unavoidably has some effect upon the other. The burden of Federal taxation necessarily sets an economic limit to the practical operation of the taxing power of the States, and vice versa. Taxation by either the State or the Federal Government affects in some measure the cost of operation of the other.

56 But neither government may destroy the other nor curtail in any substantial manner the exercise of its powers. Hence the limitation upon the taxing power of each, so far as it affects the other, must receive a practical construction which permits both to function with the minimum of interference each with the other; and that limitation can not be so varied or extended as seriously to impair either the taxing power of the government imposing the tax (South Carolina *v.* United States, 199 U. S. 437, 461; Flint *v.* Stone Tracey Co., supra, at 172) or the appropriate exercise of the functions of the government affected by it. Railroad Co. *v.* Peniston, supra, 18 Wall. 31.

We think it clear under the decisions that had the lands in question been merely State lands burdened with no special trust and held for general State purposes, there would be no question but what petitioner, as an individual lessee for private gain, would not be entitled to exemption from Federal taxation. It could not be claimed that it was an instrumentality of the State when the lease of the land would be no more than an exercise or a right of ownership by the State, a right possessed by any individual and in no sense requiring an exercise of the power peculiar to sovereignty, or in the language of the court in Flint v. Stone Tracey Co., supra, "an act essential to the execution of its governmental function and which the State can only do itself." However, in the present case, it is claimed that the

lands leased are a part of those ceded by the National Government to the State of Oklahoma, by the enabling act, for the definite and specific purpose of creating a permanent school fund to be administered in trust by the State for the maintenance of its public schools; that the acceptance of the grant created a trust in respect to such lands, undertaken by the State in its sovereign capacity, and that its every act toward performance of the trust and obtaining a school fund was one in carrying out a sovereign obligation; that in maintaining its public schools it is exercising a governmental function and that the lessees of school lands are its instrumentalities employed in the exercise of such function and accordingly exempt from Federal taxation. In support of its contention petitioner cites
57 certain decisions by the Supreme Court upon questions arising in connection with leases of tax-exempt Indian lands.

In Choctaw O. & G. R. Co. v. Harrison, 235 U. S. 292, the right of the State of Oklahoma was disputed to levy upon a railroad company an occupation tax computed upon the gross sales of coal mined by it under leases to it by the Federal Government of tax-exempt Choctaw and Chickasaw Indian lands. The court held that the treaty between these Indian tribes and the Federal Government imposed upon the latter a definite duty in respect to opening and operating these mines in their interest, and that the railroad company was the instrumentality through which this obligation was carried into effect, and as such could not be subjected to an occupation or privilege tax by the State.

In Indian Territory Illuminating Oil Co. v. Oklahoma, 240 U. S. 522, there was questioned the right of the State of Oklahoma to subject an oil and gas lease on tax-exempt Osage Indian lands to general taxation. The court held that the property in question was under the protection of the Federal Government and that the leases "have the immunity of such protection." The court further said that "it follows from these views that the assessment against the oil company, so far as it included the leases, whether as separate objects of taxation or as represented or valued by the stock of the company, is invalid."

The same principal was applied in Howard v. Gypsy Oil Co., 247 U. S. 503; and Large Oil Co. v. Howard, 248 U. S. 549, involving gross-production taxes.

In Gillespie v. Oklahoma, 257 U. S. 501, a lessee of tax-exempt Indian lands, from the Federal Government, disputed the right of the State of Oklahoma to exact a tax based upon the net income derived from operations under the lease. In holding such taxes invalid the court said:

The same consideration that invalidate a tax upon the leases invalidate a tax upon the profits of the leases, and, stopping short of theoretical possibilities, a tax upon such profits is a direct hamper upon the effort of the United States to make the best terms that it can for its wards.

It is insisted that the condition presented in this proceeding
58 is substantially similar to the one involved in the last cited case and that upon this and the other cases cited petitioner must be considered an instrumentality employed by the State of Oklahoma in the exercise of one of its sovereign powers and that to tax its income is to interfere with the exercise of that power.

In the cases cited the lands were held by the Federal Government in trust for Indian tribes. The beneficiaries of the trust were dependent wards in respect to whom a duty rested upon the Government to exact a maximum income from the trust property. The obligation of the trust was one assumed by treaty ratified by Congress and for that reason peculiarly sacred and inviolate as involving the national honor. These treaties are obligations of sovereignty and have the same effect as treaties with foreign nations. United States v. New York Indians, 173 U. S. 464; Turner v. American Baptist Missionary Foundation, 24 Fed. Cases 14251. An obligation to develop these Indian lands and to extract their mineral resources for these wards are ones specifically assumed by the Federal Government under the treaties, and the court has held that this laid upon the latter, as a sovereign, an obligation to obtain the best terms possible for its wards, and that to impose a tax upon the instrumentality through which it performs its duty, interferes with the carrying out of its obligation. In the execution of the leases involved in the cases cited the Federal Government was not merely leasing its public lands in securing revenue, but carrying out a sovereign treaty obligation.

We do not see in the facts presented in the proceeding before us a condition similar to that involved in leases of Indian lands. In the language of the court in Metcalf & Eddy v. Mitchell, supra; in referring to the Gillespie case, the condition there involved was one of taxation by one government of "an agency created and controlled by the other, exclusively to enable it to perform a governmental function." We have no such condition here. Petitioner is merely one of many lessees of school lands and if an instrumentality of the State in its furnishing of public education it is only one of many agencies of various kinds and characters, made use of as an incident of the performance of its governmental function. In this connection see Choctaw O. & G. R. Co. v. Mackay, 256 U. S.
59 531, holding that a tax upon merely one of several agencies employed by the United States in discharging its obligations toward its Indian wards can not be considered as an interference with its exercise of its governmental power to carry out that obligation. It is not controlled or directed by the State to any further extent than any other lessee of public lands. We can not see in the two cases a similarity controlling the conclusion to be arrived at in the present case.

It is true that these lands were received by the State of Oklahoma from the Federal Government to be used for the creation of a

school fund but can it be said that the act of the State in leasing them is, in view of that fact, of a different and more sovereign character than the leasing of its other public lands to obtain revenue for general State purposes. We can see in the trust arising from the ceding of these lands to the State of Oklahoma for the creating of a school fund nothing more than a designating or setting aside of this property for this purpose. The authority of the State in respect to these lands was, in so far as control and disposition of them was concerned, substantially the same as in respect of its other public lands, except that the proceeds from sale or lease should not go into its general revenues but into a permanent school fund, which was to be maintained intact, and the income therefrom used for its public schools. Can it be said that one who leases such lands from the commissioners of the land office, the instrumentality through which the State of Oklahoma controls and disposes of all of its public lands, is thereby constituted an instrumentality of the State in the performance of its governmental function of maintaining public schools, or an instrumentality of that State in the performance of a trust in respect to such lands assumed by it in its sovereign capacity, and therefore exempt from income tax upon the ground that the denial of such exemption would interfere with the securing of a more generous rental from the lessee and would lessen to that extent the amount derived for the school fund and ultimately affect a lessening of the income to be derived in the future from that fund for school maintenance, and that this would interfere with the performance by the State of its governmental function? Can it be said that such a lessee is an instru-
60 mentality necessary to the performance of the governmental function and that a tax upon its income incapacitates it to perform properly the service for which it is employed?

Let us consider for the moment the extent to which the rule insisted upon by petitioner would lead. It can not be questioned that the administration by the State of the permanent school fund secured from the sale or lease of the ceded lands is of no less sovereign character than its administration of the lands themselves in the obtaining of that fund. Under the statutes of Oklahoma this fund is administered by the commissioners of the land office and the income therefrom, which the enabling act provides shall be used for the maintenance of the public schools, is obtained by loaning it on first mortgages on land and by investment in certain specified classes of public lands. If an individual who obtains the use of school lands from the commissioners of the land office for a rental is an instrumentality of the State in the carrying out of its governmental power to maintain public schools, as is claimed, so is the individual who obtains the use of a portion of the school fund for the payment of an interest charge. If the first is exempt from taxation by the Federal Government, we see no reason why the second could not claim the same immunity, thus putting it in the power of any individual or corporation to become a tax exempt governmental

instrumentality of the State of Oklahoma by merely securing a loan from the school fund.

Can it be said that the lessee of school lands stands upon a different footing from others with whom the State deals in carrying out its function of providing public education? His connection with public education is more remote than one who builds a public school under contract with the State and whose total income from the work is paid him directly from school funds, and yet it could not be argued in the light of the decisions cited that the latter was a tax-exempt instrumentality of the State. New York Trust Co. v. United States, 63 Ct. Cls. 100; James A. Sackley Co. v. United States, U. S. Ct. Cls. (decided April 2, 1928). In American Book Co. v. Shelton, 117 Tenn. 745; 100 S. W. 725, a statute of Tennessee had provided for the use of uniform text books in the public
61 schools and for the creation of a State text book commission which should determine the books to be used and provide for their being supplied to the schools, the commission being empowered to contract with some publishing house, through public aid, for the maintaining of a depot in the State of the books selected from which they would be supplied and fixing the prices at which they might be sold. The plaintiff, as the successful bidder with whom the State contracted through the commission, claimed immunity from State ad valorem or privilege taxation, upon the ground that it was an instrumentality through which the State performed its sovereign function of providing public education. The court in denying it the immunity claimed, said:

If the fact that the book company has a contract with the State gave it immunity from taxation, the same rule would likewise exempt a manufacturer who might sell clothes for the convicts, the stationer who furnishes supplies to the State officers, and the printer who publishes the proceedings of the legislature or the Supreme Court reports, and apply to the ice dealer, who purchases his stock from the board of prison commissioners, to the coal dealer who procures his coal from the State commission, and to the dealer in hosiery who buys the output of the prison factory.

We do not think that petitioner under the facts here proven, as a lessee of public school lands in Oklahoma, for private and individual profit, stands in a position different insofar as liability for Federal income tax is concerned, from a lessee of other property of the State or property of a private individual. We can not see in the taxing by the Federal Government of its income therefrom an interference with the exercise by that State of one of its governmental powers.

The second issue involves the question of whether petitioner is entitled to a paid-in surplus in the amount of $58,538, the alleged value of the improvements on the lease on the date of its acquisition in January, 1914. In advertising for bids for releasing the land in question the commissioners of the land office notified prospective

bidders that the equipment on the land had been appraised at a
62 value of $55,800, that the land contained fifteen producing wells and that the oil production from said wells averaged 8,113 barrels per month from January 1 to November 1, 1913. The testimony establishes that the wells drilled had an aggregate depth of 29,269 feet, the reproductive cost of which amounted to $58,538 in January, 1914. The testimony further establishes that, based upon the estimated production of oil from those wells over the five-year period of the lease and upon the then prevailing price of oil, the present net worth of those improvements in January, 1914, amounted to $58,710. Upon all the facts of record, we are of the opinion that in January, 1914, the improvements, consisting of fifteen producing wells, had an actual cash value of $58,538 which attached to the lease awarded to Sutton, for the lessee acquired a five-year interest in those wells, together with a preference right to release the land for an additional five years. Sutton and his associate paid in to petitioner the physical equipment on the leased land, having an actual cash value of $55,800, and in addition, the lease, having an actual cash value of $58,538, for $25,000 par value of petitioner's stock, $25,000 of its bonds, and its note for $5,800. No evidence has been submitted as to the payment of the said bonds and note but respondent raised no question with respect thereto and has included in petitioner's invested capital the amount of $55,800, representing the cost of the physical equipment to petitioner as aforesaid. The only question presented to the board is whether petitioner is entitled to additional invested capital in the amount of $58,538 as a paid-in surplus. The lease, of the actual cash value of $58,538, having been paid in for stock in addition to other property paid in for the stock issued and of a value equal to the par value thereof, we are of the opinion that petitioner is entitled to include in invested capital the amount of $58,538 as a paid-in surplus under the provisions of section 207 of the revenue act of 1917, and section 326 of the revenue act of 1918.

With reference to the third issue, the value of $58,538 in January, 1914, of the improvements on the lease should be included in the basis upon which respondent computed the allowable deduction for depletion.

The fourth issue is relative to the proration of prior years'
63 taxes out of invested capital for each of the years involved. Such proration should be made upon the basis of the correct amount of taxes due as computed pursuant to this decision and in accordance with the commissioner's regulations.

The last issue is relative to the respondent's reduction of petitioner's invested capital for the year 1918 on account of a tentative tax computed on earnings to date of a dividend paid on November 4, 1918, which action must be held erroneous under authority of L. S. Ayers & Co., 1 B. T. A. 1185.

Reviewed by the board.

Judgment will be entered pursuant to rule 50.

GRAHAM, dissenting: The petitioner herein has leased certain oil and gas lands from the State of Oklahoma. The lands covered by

the lease were part of the lands which were conveyed by Congress to the State of Oklahoma at the time of its admission to statehood, and the restrictions which were attached to this land by the terms of the enabling act were accepted by the State of Oklahoma in its constitution and subsequently the legislature of the State passed such legislation as was necessary to carry out the terms imposed by Congress. These lands are conveniently described as school lands. The major question in this proceeding is the right of the Federal Government to impose a tax upon the income derived by this petitioner from its operation of its leases on these State-owned school lands.

That the lands here under consideration are the property of the State of Oklahoma is not questioned. Likewise it appears to be conceded that the erection and maintenance of public schools is an essential governmental function of the State. This could not be otherwise in view of the enabling acts and other legislation under and by virtue of which Oklahoma became a State and the United States conveyed to it the school lands, the income of which is here under consideration. The issue has been narrowed to the sole question of the right to tax the income derived by a lessee from State-owned school lands.

The leading case on the right of a State to tax the income of a lessee of Federal lands is Gillespie v. State of Oklahoma, 257 U. S. 501. In holding that such income could not be taxed the United States Supreme Court said:

> *A tax upon the leases is a tax upon the power to make them, and could be used to destroy the power to make them.* 240 U. S. 530. *The steps from this to the invalidity of the tax upon income from the leases is not long.*

In cases where the principal is absolutely immune from interference, and injury is allowed into the sources from which net income is derived, and if a part of it comes from such a source, the tax is pro tanto void (Pollock *v.* Farmers Loan & Trust Co., 157 U. S. 429)—a rule lately illustrated by Evans *v.* Goré, 253 U. S. 245, and applied in a case somewhat like the present by the Supreme Court of Hawaii (Oahu Ry. & Land Co. *v.* Pratt, 14 Haw. 126.) Whether this property could be taxed in any other form or not, it can not be reached as profits or income from leases such as those before us. The same considerations that invalidate a tax upon the leases invalidate a tax upon the profits of the leases; and, stopping short of theoretical possibilities, a tax upon such profits is a direct hamper upon the effort of the United States to make the best terms that it can for its wards. (Italics supplied.)

This case is the converse of the Gillespie case. There the State sought to tax income derived by the lessee of Federal lands. Here the United States seek to tax the income derived by the lessee of State lands.

It is also the law that the United States may not tax the agencies, instrumentalities or property of the States. In Van Brocklin v. State of Tennessee, 117 U. S. 151, the court said:

In Collector v. Day, 11 Wall. 113, it was adjudged that Congress had the power, even by an act taxing all income, to levy a tax upon the salaries of judicial officers of a State, for reasons similar to those on which it had been held in Dobbins v. Erie County Commissioners, 16 Pet. 435, that a State could not tax the salaries of officers of the United States. Mr. Justice Nelson, in delivering judgment, said: "The General Government, and the States, although both exist within the same territorial limits, are separate and distinct sovereignties, acting separately and independently of each other, within their respective spheres. The former in its proportionate sphere is supreme; but the States, within the limits of their powers not granted, or, in the language of the tenth amendment, 'reserved,' are as independent of the General Government as that Government within its sphere is independent of the States." 11 Wall. 124.

The reasons for exempting all the property and income of a State, or of a municipal corporation, which is a political division of the State, from Federal taxation, equally require the exempting of all the property and income of the National Government from State taxation.

If there were any remaining doubts, the court set them at rest in Pollock v. Farmers Loan & Trust Co., 157 U. S. 584, when it said:

As the States cannot tax the powers, the operations, or the property of the United States, nor the means which they employ to carry their powers into execution, so it has been held that the United States have no power under the Constitution to tax either the INSTRUMENTALITIES OR THE PROPERTY of a State.

The United States have such powers and right as have been granted to them by the several States. There is nothing in the Constitution which limits the right of either to tax the other. That these limitations exist is, however, beyond question. They grew out of the common necessity that each, within its own sphere, be free from interference from the other. I have been unable to find any intimation that the limitations are more rigorous in the case of one than in the case of the other.

If, then, as was held in the Gillespie case, the State may not tax the income derived by the lessee from the operation of lands leased from an instrumentality of the United States, it follows inevitably that the United States may not tax the income derived by a lessee from the operations of lands leased from the State of Oklahoma or one of its instrumentalities. The effect upon the lessor, of taxing the income of the lessee, is the same irrespective of which is the lessor and the same rule should be applied to either case. The income derived by a lessee on public school lands of the State of Oklahoma is not, in my opinion, subject to Federal taxation.

Marquette, Phillips, and Seifkin agree with this dissent.

Now, December 9, 1929, the foregoing findings of fact and opinion certified from the record as a true copy.

[Seal U. S. Board of Tax Appeals.]

B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

Docket No. 10503.

CORONADO OIL & GAS CO., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Decision

The above-entitled action came on for hearing on May 13, 1929, upon motion made on behalf of the respondent for settlement of deficiencies. W. F. Gibbs, Esq., appeared for 'tioner, although it appeared that counsel for the petitioner had had due notice of this motion and hearing. It further appearing that the proposed recomputation of deficiencies submitted by the respondent in support of his said motion is in accord with the findings of fact and conclusions of law promulgated January 14, 1929.

Now, therefore, upon consideration of said motion and proposed recomputation and upon all the record and files of this action, it is ordered, adjudged, and determined that the deficiencies in income and profits taxes for the several years involved are as follows:
67 for the calendar year 1917, $967.63; for the calendar year 1918, $5,942.37, and for the calendar year 1919, $808.43.

Enter.

(Signed) S. L. TRUSSELL,
Member United States Board of Tax Appeals.

SLT/dsm.

Entered May 14, 1929.

A true copy. Teste:

B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

WASHINGTON, D. C., —— —, ——.

Now, December 9, 1929, the foregoing decision certified from the record as a true copy.

[Seal U. S. Board of Tax Appeals.]

B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

[Title omitted.]

Stipulation of venue

Filed Oct. 30, 1929

It is hereby stipulated and agreed by and between the parties hereto, by their respective attorneys, that the decision and judgment of the United States Board of Tax Appeals in the above entitled cause, rendered on May 13, 1929, and entered on May 14, 1929, may be reviewed by the Court of Appeals of the District of
68 Columbia. This agreement is made under and pursuant to the provisions of Section 1003 of the Revenue Act of 1926.

Dated this 29 day of October, 1929.

(Sgd.) S. W. HAYES,
Attorney for Petitioner.

(Sgd.) C. M. CHARRET,
Attorney for Respondent.

Of counsel:

D. A. RICHARDSON,
1112 Colcord Bldg., Oklahoma City, Okla.

HUBERT L. BOLEN,
307 Tradesmen's Nat'l Bank Bldg.,
Oklahoma City, Okla.

T. P. GORE,
1040 Woodward Building, Washington, D. C.

Now, December 9, 1929, the foregoing stipulation certified from the record as a true copy.

[Seal U. S. Board of Tax Appeals.]

B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

[Title omitted.]

Notice

Filed Oct. 30, 1929

To C. M. CHARRET, Esq.,
General Counsel, Bureau of Internal Revenue,
Washington, D. C.,
Attorney for Respondent.

SIR: Please take notice that on the 30th day of October, 1929, the undersigned will present to the United States Board of Tax Appeals, and file with the clerk thereof, the petition of the Coronado Oil and

Gas Company, a copy of which is annexed hereto, for the review by the Court of Appeals of the District of Columbia of the final order and decision of the United States Board of Tax Appeals in the above entitled proceeding, rendered on May 13, 1929, and entered upon the records of said Board of Tax Appeals on May 14, 1929.

Dated at Washington, D. C., October 29th, 1929.

(Sgd.) S. W. Hayes,
T. P. Gore,
Attorneys for Coronado Oil and Gas Company.

Of counsel:
D. A. Richardson,
1118 Colcord Bldg., Oklahoma City, Okla.
Hubert L. Bolen,
307 Tradesmen's Natl. Bank Bldg., Oklahoma City, Okla.
T. P. Gore,
1040 Woodward Building, Washington, D. C.

Service of copy of the within and foregoing notice, with attached thereto copy of petition for review referred to therein is hereby accepted this 30th day of October, 1929.

(Sgd.) C. M. Charest,
General Counsel, Bureau of Internal Revenue and Attorney for Respondent.

Before United States Board of Tax Appeals

[Title omitted.]

Petition for Review

Filed Oct. 30, 1929

To the Honorable the Chief Justice and the Associate Justices of the Court of Appeals of the District of Columbia:

Your petitioner is aggrieved by decision and judgment or order of the United States Board of Tax Appeals, rendered against it on May 13, 1929, and entered on May 14, 1929, in the case of Coronado Oil and Gas Company, petitioner, vs. Commissioner of Internal Revenue, respondent, No. 10,503, on the docket of the United States Board of Tax Appeals.

Nature of the case

(1) The petitioner is a corporation, organized and existing under the laws of the State of Oklahoma, with its office at Cleveland, Oklahoma, and is engaged in the business of exploring for, developing, and mining petroleum oil and gas and selling the same.

(2) The petitioner's entire income for the calendar years 1917, 1918, and 1919, was derived by it from the sale of crude petroleum,

produced and mined by it from certain common school lands owned by the State of Oklahoma, under oil and gas leases executed to the petitioner for the purpose of exploring, developing, and operating said school lands for production of crude petroleum oil and gas.

(3) The lands covered and included in said oil and gas mining leases from which petitioner produced during the years 1917, 1918, and 1919, all the petroleum and oil from the sales of which it derived and received all its income during said years were granted to the State of Oklahoma by an act of Congress approved June 6, 1906, entitled, "An Act to enable the people of Oklahoma and of the Indian Territory to form a constitution and State government and be admitted into the Union on equal footing with the original States; and to enable the people of New Mexico and of Arizona to form a constitution and State government and be admitted into the Union on an equal footing with the original States." (Chapter 3335, United States Statutes, 1905–1906, part 1, p. 267.)

(4) Section 7 of said act granted to the State of Oklahoma, upon its admission into the Union, sections 16 and 36 in every township in Oklahoma Territory for the use and benefit of the common schools of the State.

(5) Section 8 of the same act provided that where any of said lands granted to the State are valuable for minerals, including gas and oil, such lands shall not be sold by the State prior to
71 January 1, 1915, but that the same may be leased for periods not exceeding five (5) years by the proper officers of the State, and that all proceeds from such leases shall be converted into the fund to which they shall properly belong and that no transfer or assignment of any lease shall be valid or confer any right in the assignee without the consent of the proper State authorities in writing.

(6) The leases from which the income of petitioner was derived during said years covered and included the south half (S. ½) of the northwest quarter (NW. ¼), the southwest quarter (SW. ¼), the northeast quarter (NE. ¼), and the south half (S. ½) of the southeast quarter (SE. ¼) of section sixteen (16), township twenty-one (21) north, range eight (8) east of the Indian meridian.

(7) The statutes of Oklahoma, which authorized the commissioners of the land office of the State of Oklahoma to lease said lands for oil and gas purposes, provided that such lease should be made subject to the rules and regulations of the commissioners of the general land office, and said leases to the petitioner provided by their terms that said leases shall in all respects be subject to the rules and regulations theretofore or thereafter lawfully prescribed by the commissioners of the land office of the State of Oklahoma, relative to oil and gas leases on public lands, not in conflict with the lawful terms of the lease, and that neither said leases nor any interest therein should be sublet, assigned, or transferred without the consent of the commissioners of the land office first obtained in writing; and

(8) The rules and regulations of the commissioners of the land office of Oklahoma, under which said leases were made to the petitioner, and the provisions of said leases, required that petitioner should give a bond to the State of Oklahoma in substance that it, as lessee, would faithfully perform the terms and conditions of the lease, and said bonds were given by the petitioner.

(9) One of said leases provided and required that the petitioner, as lessee therein, should pay to the State of Oklahoma a royalty of fifty (50%) per cent of all the oil and gas produced under said lease, and the other of said leases provided for the payment to the State as a royalty one-eighth (⅛) part of the oil and gas produced from the premises covered by such leases.

(10) The Commissioner of Internal Revenue determined that the income derived and received by petitioner from the sale of petroleum oil mined by it from aforesaid common school lands owned by the State of Oklahoma under said oil and gas mining leases, during the years 1917, 1918, and 1919, was subject to Federal income and profits taxes for said years. From this decision of the Commissioner of Internal Revenue the taxpayer appealed to the United States Board of Tax Appeals.

(11) Said appeal was submitted to the United States Board of Tax Appeals upon petitioner's petition, as amended, the commissioner's answer thereto, evidence introduced at a hearing thereon, oral argument by counsel and printed briefs; and the Board of Tax Appeals on May 13, 1929, rendered its decision which was, on May 14, 1929, entered, by which the United States Board of Tax Appeals decided, ordered, and adjudged that there were deficiencies in the income and profits taxes of the petitioner for the several years involved as follows:

For the calendar year 1917	$967.63
For the calendar year 1918	5,942.37
For the calendar year 1919	308.43

For the foregoing reasons, and upon the assignments of error hereinafter made, the petitioner files this its petition for review by this honorable court.

Court of review

A review of the aforesaid decision of the United States Board of Tax Appeals in the above entitled proceeding is sought by the Court of Appeals of the District Court of Columbia and the parties to said proceeding have agreed, as evidenced by stipulation filed with the clerk of the United States Board of Tax Appeals, that said review shall be in this court.

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Assignments of error

As grounds of review of said decision and as reasons why said decision should be reversed by this court, your petitioner believes and avers that errors were committed by the United States Board of Tax Appeals to its damage and prejudice as follows:

(1) That the United States Board of Tax Appeals erred in determining, deciding, and adjudging that the net income derived by petitioner from the sale of petroleum oil produced by it from the aforesaid common school lands owned by the State of Oklahoma, under oil and gas mining leases duly made to petitioner for oil and gas mining purposes, is subject to Federal income and profits taxes.

(2) That the United States Board of Tax Appeals erred in refusing to hold that the provisions of the revenue act of 1916, as amended by the revenue act of 1917, as amended by the revenue act of 1918, insofar and to the extent that said acts respectively authorize and direct, or attempt to authorize and direct, the assessment and levy against the collection from petitioner of income and excess profits taxes upon or because of the net income derived by petitioner during the years 1917, 1918, and 1919, from the sale of petroleum oil produced by it from the aforesaid common school lands owned by the State of Oklahoma, under oil and gas mining leases duly made to the petitioner for oil and gas mining purposes, are unconstitutional and void and without the power of the Congress of the United States to enact.

(3) That the United States Board of Tax Appeals erred in holding that there were deficiencies in income and excess profits taxes of the petitioner for the years 1917, 1918, and 1919, in the amounts of $967.63, $5,942.37, and $308.43, respectively, or in any amounts.

Wherefore your petitioner prays that the decision of the Board of Tax Appeals entered herein against it be reviewed and
74 reversed by this honorable court, and for such other and further relief as this honorable court may deem meet and proper in the premises.

CORONADO OIL AND GAS COMPANY,
By S. W. HAYES,
T. P. GORE,
Attorney of Record, 1112 Colcord Building, Oklahoma City, Oklahoma.

Of counsel:

D. A. RICHARDSON,
1112 Colcord Building, Oklahoma City, Okla.
HUBERT L. BOLEN,
307 Tradesmen's National Bank Bldg., Oklahoma City, Okla.
T. P. GORE,
1040 Woodward Building, Washington, D. C.

STATE OF OKLAHOMA,
Oklahoma County, ss:

Personally appeared before me, the subscriber, a notary public in and for the county and State aforesaid, S. W. Hayes, who, upon being duly sworn, according to law, does depose and say that he is attorney of record of Coronado Oil and Gas Company, the peti-

tioner above named, and that as such he had authority to and did sign the foregoing petition; that he has read the same and that to the best of his knowledge and belief the facts set forth therein are true, that the assignments of error are well taken and that said petition is filed in good faith.

S. W. HAYES.

Subscribed and sworn to before me this the 22 day of October, 1929.

[Seal of Helen D. Brimi, notary public, State of Oklahoma.]

HELEN D. BRIMI,
Notary Public.

My commission expires October 15, 1933.

Now, December 9, 1929, the foregoing petition for review, notice of filing and proof of service certified from the record as a true copy.

[Seal U. S. Board of Tax Appeals.]

B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

75 Before United States Board of Tax Appeals

Docket No. 10503

IN THE MATTER OF CORONADO OIL & GAS COMPANY, PETITIONER

VS.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Statement of evidence

Lodged 11-19-29. Filed Dec. 5, 1929.

Caption

The above-entitled cause came on for hearing before Honorable William R. Green, jr., member of the United States Board of Tax Appeals, on the 3rd day of February, 1927, there being present the petitioner, by its counsel, Hubert L. Bolen, J. P. Alkire, and S. W. Hayes, and the respondent by his counsel, Dwight H. Green and Maxwell E. McDowell. Prior to the introduction of testimony the following colloquy took place:

Mr. DWIGHT W. GREEN. If your honor pleases, this case does not stand at issue at the present time. The situation is this: An amended petition has been filed by the petitioner and no answer has ever been entered by the commissioner, and I ask leave at this time to enter a general denial for the commissioner to the allegations of fact set forth in the amended petition.

Mr. GREEN. I take it there is no objection to that?

Mr. Bolen. None whatever.

Mr. Graw. Very well. The commissioner's answer by way of general denial will be treated as having been made in the record. You may make your opening statement.

Mr. Bolen. This is a deficiency tax for the years 1917, '18, and '19, the petitioner claiming that there was no—that the commissioner allowed no expenses on invested capital for the cost of drilling wells, and so forth, on the lease. The lease was acquired at first by Dr. Sutton and afterwards transferred to the Coronado Oil and Gas Company and the further question in the case is that this is
76 State-owned school land and that the lease or the income derived from the lease on such school land is not taxable by the Federal Government for income taxes.

Other colloquy occurred relative to the first issue stated by Mr. Bolen above, but, since that issue will not be presented on appeal, it is omitted.

Whereupon the petitioner maintaining the issues on its behalf introduced the following testimony:

W. A. Durant, being first duly sworn, in substance testified:

I reside at Oklahoma City and hold the office of secretary to the commissioner of the land office. The commissioner of the land office is charged with the duty of leasing the school lands and public lands of the State for agricultural and mineral purposes. The secretary of the commissioner of the land office is custodian of all the documents and records pertaining to all the acts of the commissioners of the land office in leasing school lands and other public lands of the State.

Witness then identified a book as the record of *of* the minutes of the commissioner of the land office kept by the State of Oklahoma, and a portion thereof as being the minutes of a meeting of the commissioners of the land office held on September 18, 1918. Whereupon there was introduced in evidence by petitioner a portion of said minutes, as follows:

"In re appointment of appraisers to appraise oil and gas improvements it was moved and seconded that Frank Orr be selected and designated as appraiser on behalf of the State for the purpose of appraising improvements and other necessary appliances used in connection with the operation of any producing wells on the south half of the northwest quarter, and the southwest quarter, and the northeast quarter, and the south half of the southeast quarter of section 16, township 21, range 8 east of Indian meridian, at their fair and reasonable value. All voted aye: Motion prevailed."

Thereupon the witness Durant identified a record of the min-
77 utes of the meeting of the commissioners of the school land office held on December 4th, 1918, and the witness testified: These minutes contain action on notice to be given by the commissioners of the land office of the State for bids for leasing the northeast quarter and the south half of the northwest quarter and the southwest quarter, and the south half of the southeast quarter of

section 16, township 21 north, range 8 east, Indian meridian for oil and gas purposes. Said notice of bids was introduced in evidence by petitioner and is as follows:

Offer in evidence

Notice of receiving bids for leasing State and school lands for oil and gas purposes.

Notice is hereby given that the commissioners of the land office of the State of Oklahoma will receive sealed bids at the office of the secretary, fifth floor Mercantile Building, Oklahoma City, Oklahoma, at four o'clock p. m., on the 7th day of January, 1914, to be opened immediately thereafter in the presence of the bidders, for the re-leasing of the following described public lands belonging to the State of Oklahoma, to-wit:

Northeast quarter, and south half of the northwest quarter, and southwest quarter, and south half of southeast quarter, all in section 16, township 21 north, range 8 east, Indian meridian, containing four hundred and eighty (480) acres.

Said lands to be leased for oil and gas purposes is for a term of five years with preference right to re-lease for an additional period of five years under and within the terms of the laws of Oklahoma and the rules and regulations of the commissioners of the land office at a royalty of fifty (50%) per cent of the total output of all oil and gas from said lands, and in addition thereto such bonus as may be offered therefore.

All bids must be on forms furnished by the commissioners of the land office, and each bid must be accompanied by a certified check or bank draft on some bank within the State of Oklahoma for the sum of three thousand ($3,000.00) dollars, payable to the commissioners of the land office of the State of Oklahoma, said sum being deposited as earnest money. All deposits accompanying rejected bids will be returned to such bidders as soon thereafter as practicable. But in the event that any successful and accepted
76 bidder shall fail or refuse to comply with the terms and conditions of said bid, such deposit by him shall be forfeited thereby, and shall become the property of the State of Oklahoma, for use and benefit of the proper fund under control of the commissioners of the land office.

Each bidder shall deposit the sum of fifty-five thousand and eight hundred ($55,800.00) dollars in cash, or by bank draft drawn by some bank in the State of Oklahoma, for the improvements located on said land and now used in connection with the oil and gas wells being operated by the Southwestern Oil Fields Company, said improvements having been duly appraised, and the value of same fixed in the above amount, as provided by law and the rules and regulations of the commissioners of the land office; said sum of money to be paid over to the Southwestern Oil Fields Company, a corporation,

in the event it elects not to take a lease on said land at the highest and best bid received, as determined by the commissioners of the land office.

The terms and conditions of said lease to be executed shall conform to and be governed by and be interpreted and construed by the laws of the State of Oklahoma and the rules and regulations of the commissioners of the land office.

The above described lands have fifteen wells thereon producing oil at this time. The total gross production therefrom for the month of October, 1913, was seven thousand two hundred and seventy-five (7,275) barrels of oil. The total oil production from said lands from January 1st to November 1st, 1913, was eighty-one thousand one hundred and thirty-eight (81,138) barrels. The average production for the ten months being eight thousand one hundred and thirteen (8,113) barrels per month.

For further information as to production, improvements, and form of bid, and rules for bidding, address John R. Williams, Secretary, Oklahoma City, Oklahoma.

Dated this 4th day of December, 1913.

(Signed) LEE CRUCE,
Governor and Chairman.

Attest:

JOHN R. WILLIAMS,
Secretary.

79 The witness Durant thereupon identified a record of the minutes of the commissioners of the land office, adopting rules and regulations for leasing public lands for oil and gas purposes covering aforesaid lands, which rules and regulations were introduced in evidence by petitioner and are as follows:

Offer in evidence

Rules and regulations for leasing public lands for oil and gas purposes

Bids to be received on the following described lands:

Northeast quarter, and south half of northwest quarter, and southwest quarter, and south half of southeast quarter, all in section 16, township 21 north, range 8 east, Indian meridian, containing four hundred and eighty (480) acres.

Rule 1. All bids must be on forms furnished by the commissioners of the land office, and must be filed with the secretary at four o'clock p. m., on the 9th day of January, 1914, to be opened immediately thereafter.

Rule 2. All bidders will be required to deposit a certified check or bank draft on some bank within the State, for the sum of three thousand ($3,000.00) dollars, payable to the commissioners of the land office to be held as earnest money as outlined in the advertisement.

Rule 3. The highest responsible bidder will be required to give bond, to be approved by the commissioners of the land office for the faithful performance of his contract, and to develop the lands sufficiently to extract all the oil and gas thereunder with the least possible delay.

Rule 4. The royalty shall be fifty (50%) per centum of the total output of oil and gas from said lands, and all bonuses must be offered in addition to the fixed royalty. Should bonus be offered in cash, the same must be paid to the commissioners at the time of the execution of the lease, and if in oil, the bidder must offer a definite and specific percentage of the gross production in addition to the fixed royalty of fifty (50%) per cent above set out.

Rule 5. All producing wells that are now or may hereafter be drilled on adjoining properties to be offset by corresponding wells on the lands to be leased under these rules.

Rule 6. Certified copies of pipe line runs, and all sales and shipments to be furnished monthly, or on demand.

Rule 7. Accurate and reliable information concerning wells and their operation and management to be furnished on demand to the commissioners of the land office, or any one authorized to act for them.

Rule 8. The lease to conform to and be interpreted and construed by the laws of the State of Oklahoma, and the rules of the commissioners of the land office.

Rule 9. The Southwestern Oil Fields Company, a corporation, by virtue of its lease heretofore held upon said lands, under the law, is entitled to the preference right to re-lease said land at the maximum rate of rentals, royalties and bonuses that may be obtained therefor, said preference right to take at the highest and best bid to be exercised within five (5) days after the award by the commissioners of the land office.

(Signed) LEE CRUCE,
Governor and Chairman.

Attest:

JOHN R. WILLIAMS,
Secretary.

Thereupon was introduced in evidence by the petitioner that portion of the minutes of a meeting of the commissioners of the State school land office of date December 4, 1913, which reflects the action of the board of commissioners of the land office on aforesaid motions and regulations, which is as follows:

Offers in evidence

It was moved and seconded that the above notice of receiving bids, rules, and regulations and form of bid, be and the same are hereby adopted and approved. All vote aye: Motion prevailed.

Mr. Michaelson, attorney for the Southwestern Oil Fields Company, and the members of the board discussed the matter of royalty to the State to be paid by said company from the production of oil and gas from the above described lands from the 14th day of November, 1913, the date on which the lease of the Southwestern Oil Fields Company's lease expires, to the date when the land will be re-leased under the notice of advertisement herein adopted, without reaching an agreement.

81 It was moved and seconded that if the Southwestern Oil Fields Company does not enter into an agreement for the operation of the lease from the expiration of its lease to the date the same is released under the above advertisement, at a royalty for which the same is re-leased for the second term of five years, then, in that event, that a receiver be asked for to operate and handle said property.

All vote aye: Motion prevailed.

Thereupon, Mr. Michaelson requested time in which to consult his company relative to the matter, and same was agreed to not to exceed ten days time from this date.

Witness Durant thereupon turned to and identified the minutes of the meeting of the commissioners of the land office held on January 12, 1914, and testified:

These minutes reflect the bids for oil and gas leases on the tracts of land I have heretofore been asked about and show bids to have been made by the Southwestern Oil Fields Company and by George W. Sutton.

Thereupon is introduced in evidence by petitioner a portion of aforesaid minutes of the said meeting of the commissioners of the land office on January 12, 1914, as follows:

Mr. Bryan, on behalf of the oil and gas committee, presents the following report, to wit:

OKLAHOMA CITY, OKLAHOMA, *January 9, 1914.*

COMMISSIONERS OF THE LAND OFFICE,
State of Oklahoma.

GENTLEMEN: We, your oil & gas committee, beg leave to submit the following report, to wit:

On January 9, 1914, at four o'clock p. m., we received and opened bids for the re-leasing of the northeast quarter, and south half of northwest quarter, and southwest quarter, and south half of southeast quarter of section 16, township 21 north, range 8 east, Indian meridian, containing four hundred and eighty acres,

82 more or less, in accordance with the published advertisement and rules and regulations governing the same, as follows:

Bid for leasing public school lands

To the Commissioners of the Land Office of the State of Oklahoma.

GENTLEMEN: Application is hereby made to lease for oil and gas purposes, under the laws of the State of Oklahoma, and the rules

and regulations lawfully made by the commissioners of the land office, the following described lands in Pawnee County, Oklahoma, to wit:

Northeast quarter (NE. ¼), and south half (S. ½) of northwest quarter (NW. ¼), and southwest quarter (SW. ¼), and south half (S. ½) of the southeast quarter (SE. ¼) of section sixteen, township twenty-one (21) north, range eight (8) east, containing four hundred and eighty acres (480), more or less.

Your applicant being the present owner and in possession of the improvements and equipment on the above described land, draft for fifty-five thousand eight hundred ($55,800.00) dollars, the appraised valuation of said improvements, does not accompany this bid.

Draft number 43419 in the sum of three thousand ($3,000.00) dollars, issued by the Bartlesville National Bank of Bartlesville, Oklahoma, is herewith deposited with this bid, as earnest money, and made payable to the commissioners of the land office, under the terms of the advertisement.

Your applicant hereby bids for said oil and gas mining lease, a royalty of twelve and one-half per cent (12½) and a bonus in addition thereto in the sum of fifteen thousand ($15,000.00) dollars.

This bid is made under the express condition that the bidder does not in any manner waive its preference right given it under its lease covering the above described land, and by law to take said lease as advertised at the highest bid therefor if it so elects.

83 Dated at Bartlesville, Oklahoma, this 9th day of January, 1914.

(Signed) SOUTHWESTERN OIL FIELDS COMPANY,
By C. H. MCCREADY,
General Manager.

Form of bid for leasing public lands

To the COMMISSIONERS OF THE LAND OFFICE,
State of Oklahoma.

GENTLEMEN: Having read the foregoing rules and regulations for leasing public lands for oil and gas purposes, application is hereby made to lease under the laws of Oklahoma and the rules and regulations of the commissioners of the land office, the following described lands:

The south half of the northwest quarter (S. ½ of NW. ¼), the southwest quarter, the northeast quarter, and the south half of the southeast quarter (S. ½ of SE. ¼) of section 16, township 21 north, range 8 east, in Pawnee County, Oklahoma.

Draft number 527, in the sum of fifty-five thousand eight hundred ($55,800.00) dollars, on the State National Bank of Oklahoma City, Oklahoma, in the State of Oklahoma, accompanies this bid, and is made payable to the commissioners of the land office and deposited

under the rules and the published advertisement, and in the event that the lease is awarded and executed to the bidder hereunder, this draft is to be used for the purposes of paying for the improvements now on the above described lands, and belonging to the Southwestern Oil Fields Company, and appraised at the said sum of fifty-five thousand eight hundred ($55,800.00) dollars.

Certified check in the sum of three thousand ($3,000.00) dollars, issued by the First National Bank of Cleveland, Oklahoma, accompanies this bid, and is deposited as earnest money, and made payable to the commissioners of the land office, under the terms of the advertisement, and the rules of the commissioners.

In addition to the fifty per centum royalty determined and
84 fixed by the commissioners of the land office I agree to pay a bonus of no per cent of the gross production of oil produced on said lease, or — ($no) dollars.

In addition to the fifty per centum royalty determined and fixed by the commissioners of the land office I agree to pay a bonus of no per cent of the gross production of gas produced on said lease, or — ($no) dollars.

(Signed) GEORGE W. SUTTON,
Cleveland, Oklahoma.

And your committee herewith tenders the original bids to the commissioner of the land office for their consideration, with recommendation.

Respectfully submitted.

(Signed) G. T. BRYAN.

After carefully considering the two bids received, it was moved and seconded that George W. Sutton be declared the highest responsible bidder, and that his bid be declared the highest and best bid received, and that he be awarded a lease upon the above-described land for a period of five years, under the law, rules, and regulations governing the same, in accordance with the bid submitted by him, provided the Southwestern Oil Fields Company, a corporation, elects not to take a lease upon said land at the royalty agreed to be paid by the said George W. Sutton, as set out in his bid, as provided in rule 9 of the rules and regulations promulgated for the leasing of said land.

Provided further, that if the Southwestern Oil Fields Company, a corporation, in the exercise of its preference right takes same at the high bid so received, then in that event a lease be awarded to said company for a second period of five years, as provided by law and the rules and regulations in such case made and provided.

All vote aye: Motion prevailed.

Thereupon the witness Durant identified the record of the minutes of the proceedings of the commissioners of the land office at a meeting held January 16, 1914, of which minutes of the actions of the commissioners of the land office at said meeting the following part was introduced in evidence by the petitioner:

85 The secretary reported that the Southwestern Oil Fields Company, in the exercise of their preference right, elected not to take a lease for the second term of five years upon the award recently made to G. W. Sutton of Cleveland, Oklahoma, upon the following described land:

Northeast quarter, (NE. ¼), and south half of northwest quarter (S. ½ of NW. ¼), and southwest quarter (SW. ¼) and south half of southeast quarter (S. ½ of SE. ¼), all in section 16, township 21 north, range 8 east, Indian meridian.

And thereupon after possession of the lease and improvements had been delivered to Mr. Sutton, the amount deposited in the sum of fifty-five thousand eight hundred ($55,800.00) dollars for improvements, was paid over to the Southwestern Oil Fields Company.

It was moved and seconded that the action of the secretary be confirmed and approved, and that the chairman and secretary be authorized to enter into a lease contract with G. W. Sutton for a term of five years, as provided by law, and the rules and regulations governing the recent bidding, and that his bond be fixed at ten thousand ($10,000.00) dollars, same to be surety company bond.

All vote aye: Motion prevailed.

At the request of Dr. G. W. Sutton, it was moved and seconded that the lease awarded to him on the northeast quarter (NE. ¼), and south half of northwest quarter (S. ½ of NW. ¼), and southwest quarter (SW. ¼), and south half of southeast (S. ½ of SE. ¼) in section 16, township 21 north, range 8 east, Indian meridian, be made to Coronado Oil and Gas Company.

All vote aye: Motion prevailed.

Thereupon the witness Durant testified: As secretary of the commissioners of the land office I have in my custody the lease which was executed pursuant to the foregoing action of the commissioners of the land office and the lease which I hold was executed by the commissioners of the land office to the Coronado Oil and Gas Company on the south half of the northwest quarter (S. ½ of NW. ¼), the southwest quarter (SW. ¼), and the northeast quarter (NE.
86 ¼), and the south half of the southeast quarter (S. ½ of SE. ¼) of section 16, township 21 north, range 8 east, Indian meridian, as of date of January 17, 1917.

Said lease was thereupon offered and introduced in evidence by petitioner and is as follows:

Offer in evidence

Oil and gas mining lease

This indenture of lease, made and entered into in duplicate on this 17th day of January, 1914, by and between the commissioners of the land office of the State of Oklahoma, hereinafter styled the lessors, parties of the first part, and Coronado Oil and Gas Company, hereinafter styled the lessee, party of the second part,

Witnesseth: That under and in pursuance of the constitution and laws of the State of Oklahoma, the said lessors, for and in consideration of the royalty, covenants, and stipulations and conditions herein expressed and hereby agreed to be paid, observed, and performed by the said lessee, its successors and assigns, do hereby lease and let unto the said lessee and its successors and assigns for a term of five (5) years from and after the date hereof all oil deposits and natural gas in or under the following described tract of land lying in the county of Pawnee, in the State of Oklahoma, to wit:

The south half of the northwest quarter, the southwest quarter, the northeast quarter and the south half of the southeast quarter of section sixteen (16), township twenty-one (21) north, range eight (8) east I. M.

Which said lands are public lands belonging to the State, and were by the said commissioners of the land office declared to be valuable for oil and gas purposes, and the said oil and gas deposits therein contained were by the said commissioners of the land office segregated from the surface use and interest therein, with the right to prospect for, extract, pipe, store, refine, and remove such oil and natural gas, with the right to use and keep so much of the said surface of said premises as may be necessary to prosect for, extract, pipe, store, refine, and remove such oil and natural gas, including still further the right to use a sufficient amount of such oil and natural gas as fuel, light, and power so far as may be neces-

87 sary to the prosecution of said operations, and with the further right to use any water on said premises that may be necessary to carry on said operations, in consideration whereof the lessee hereby agrees to pay a royalty of fifty (50%) per centum of all the oil and gas produced and sold from the fifteen wells now in operation upon the said premises, and to operate the same to their full capacity, and not to abandon or plug any well now upon the said lands without written consent of the commissioners of the land office first obtained in writing.

All oil and gas due to the State under this contract shall be delivered by the lessee herein or his assigns free of cost to the State into pipe lines, tanks, or cars, or settled for before removing the same from the premises if sold in any other way. Certified copies of gauge tickets, sales, and shipments to be furnished at the request of the commissioners or any one authorized to act for them; gas to be metered on the premises under high pressure unless some other method of gauging and measuring same shall be hereafter agreed upon in writing.

The lessee further covenants and agrees to exercise diligence in the sinking of wells for oil and gas purposes on the lands covered by this lease, and to drill a sufficient number of wells on said premises to offset each and every well drilled upon adjoining premises, and the said lessee is hereby required and binds itself to develop said premises as is required by the laws of the State of Oklahoma,

and the rules and regulations adopted by the commissioners of the land office.

Whenever any well shall hereafter be drilled adjoining said premises and such well shall produce oil or gas in paying quantities, then within fifteen days thereafter the lessee herein shall begin the drilling of offset wells as above provided and development of oil and gas on such land herein shall be sufficient to extract all oil and gas therefrom with the least possible delay.

The said lessee shall operate the leased premises for oil and gas to as full an extent as individual and corporate premises are being operated within the general oil and gas field where such lands are located, and the failure to do so shall forfeit this lease to the State, and thereupon the commissioners of the land office shall be entitled to take immediate possession of said lands and all improvements thereon. Accurate and reliable information concerning all wells and their operation and management to be furnished on demand of the commissioners of the land office. The said party of the second part further agrees to carry on operations in a workmanlike manner to the fullest possible extent; to commit no avoidable waste on the said land, and to suffer no avoidable waste to be committed upon the portion of its occupancy or use; to take good care of the same, and to promptly surrender and return the premises upon the termination of this lease.

The tools, boilers, power houses, lines, pumping, and drilling outfits, tanks, engines and machinery (and casing of all dry and exhausted wells) shall remain in the property of the party of the second part, and may be removed by them at any time before or at the expiration of this lease.

The casing, derricks, boilers, power houses, power plants, lines, tanks, tubing, rods, pumping and drilling outfits, engines and machinery, tools and all other appliances necessary to be used in the operation of any producing well on the lease, shall be appraised six months prior to the expiration of this lease contract, in order to ascertain the fair and reasonable value thereof by appraisers, one to be appointed by the commissioners of the land office, and one by the lessee herein named or its assignee holding said lease at the time, and if said appraisers be unable to agree upon the fair and reasonable value of all such property of the lessee or its assigns on said premises the two appraisers so appointed shall have the right and authority to appoint a third person, and the appraisement of a majority of said three appraisers shall be binding upon both parties hereto. It being expressly understood that the actual sale value of the materials and improvements mentioned at the time of appraisement shall alone be considered and no expense incurred in drilling, except materials permanently used in the operation of the well, shall be considered as improvements.

In advertising said land for re-lease for a second term of five years, the appraised values of said property of the lessee on the

lease shall be stated in said advertisement, and any bidder
89 other than the lessee herein named or its assignee shall be required to deposit the appraised value thereof with the commissioners of the land office at the time the bid for the second term of five years is made, and if the lessee herein named or its assignee does not succeed in leasing said premises for a second period of five years, then in that event said amount shall be paid over to the lessee herein named or its assignee, provided, however, that all royalties, rentals, charges, and claims have been paid; that it will not permit any nuisance to be maintained on the premises under its control; that it will not use such premises for any other purpose than those authorized in this lease. Said second party further obligates itself and agrees not to plug, abandon, or pull the casing from any well, productive or otherwise, without first securing the written consent of the first party, or its duly authorized agent, and it is further mutually agreed that a violation of this provision shall work a forfeiture of this lease at the option of the first party, and that before abandoning any well under said written consent it will securely plug the same so as to effectually shut off all water above and below the oil-bearing horizons according to law.

And the said party of the second part further covenants and agrees that it will keep an accurate account of all oil and gas mining operations, showing the sales, prices, dates of purchase, and the whole amount of oil and gas mined and removed; and all sums due as royalties shall be a lien on all implements, tools, movable machinery and all other personal chattels used in said prospecting and mining operations and upon all the unsold oil obtained from the land herein leased as security for the payment of said royalty. And it is mutually understood and agreed that this indenture of lease shall in all respects be subject to the rules and regulations heretofore or that may hereafter be lawfully prescribed and not in conflict with the lawful terms of this lease by said commissioners relative to oil and gas leases of public lands, and that this lease or any interest therein shall not be sublet, assigned or transferred without the consent of the commissioners of the land office first obtained in writing. And it is further mutually understood and agreed that this lease is not executed to or in the interest of any
90 pipe line or transportation company, or any company allied to or confederated therewith or any subsidiary company thereof, nor any other company, corporation, person, or association under the control of either or all of them, nor to any stockholder, officer, director, agent, representative, or employee, acting singly or as a firm, or corporation of such companies or either of them, and that should the second party or its assigns violate any of the covenants, stipulations, or provisions of this lease, or any of the regulations, or fail for a period of sixty days to pay the stipulated royalties provided herein, then the commissioners, after ten days notice to the parties hereto, shall have the right to avoid this indenture of lease and cancel the same.

If the lessee makes reasonable and bona fide efforts to find and produce oil in paying quantities as herein required of it, and such effort is unsuccessful, it may at any time thereafter surrender and wholly terminate this lease upon the full payment and performance of all its then accrued and payable obligations hereunder.

It is agreed that for any refinery of crude oil and its products and by-products owned and controlled by the State of Oklahoma the State shall have the preference right to purchase and receive the output from said premises at the market prices therefor; providing that the lessee may sell the said output to any firm, corporation, or person whatsoever until notice in writing from the commissioners of the land office has been served upon the lessee that the State of Oklahoma is ready to take such oil or gas or either of them.

The lessee, its successors, or assigns, shall have the preference right to re-lease said premises for a second term of five years at the expiration of this lease, at the maximum rate of rentals, royalties, and bonuses that may be obtained therefor at the time of such renewal. Said maximum rate shall be determined by such reasonable and lawful regulations as are now or may hereafter be prescribed by the commissioners of the land office or other person or persons authorized thereto by the State of Oklahoma.

The term "Commissioners of the land office of the State" as used in this lease shall include any board, person, or persons who are or may hereafter be authorized by law to act in behalf of the State
91 in the matters relating to the leasing of the public lands of the State of Oklahoma for oil and gas purposes.

It is further agreed and understood that the approval of this lease by the commissioners shall be of no force nor effect unless the party of the second part furnish a bond in the sum of ten thousand dollars ($10,000.00) to the satisfaction of said commissioners, in accordance with the regulations of said commissioners, which shall be deposited and remain on file in the office of the commissioners of the land office of Oklahoma.

And it is agreed that the lessee shall, at the expiration of each quarter after the premises produces oil and gas, or either of them, for the quarter prior to the said report, and whenever said production reports, computed together or singly vary from the sales report, the lessee, upon the proper showing and proof shall be given credit on the production report or reports for the amount of shrinkage.

The said lessee binds and obligates itself to do and perform all of the conditions imposed on it by law and this lease and obligates itself to protect the State of Oklahoma from all damage, loss, charges, and claims of every kind or nature, by reason of a failure to comply in whole or in part with the terms of this lease as herein imposed, this lease and all rights and privileges inuring to the benefit of the said lessee may be forfeited and cancelled, and the said commissioners for and on behalf of the State of Oklahoma shall be entitled to recover from the lessee's bondsmen all rents,

royalties, charges, and claims of every kind and nature due and owing and accruing and arising out of and by reason of this lease.

In witness whereof, the said parties have hereunto subscribed their signatures, the day and year first above written.

THE COMMISSIONERS OF THE LAND OFFICE OF THE STATE OF OKLAHOMA,

(Signed) By LEE CRUCE,
Governor of the State of Oklahoma and Chairman of said Commissioners.

92 Attest:
[SEAL.] JOHN R. WILLIAMS,
Secretary.

CORONADO OIL AND GAS COMPANY,

(Signed) By G. W. SUTTON, *President.*

Attest:
GEO. REYNOLDS.

STATE OF OKLAHOMA,
Pawnee County, ss:

Before me, W. H. Boles, a notary public within and for said county and State, on this the 23rd day of January, 1914, personally appeared G. W. Sutton, to me known to be the president of Coronado Oil & Gas Company, and acknowledged to me that he executed the above instrument as his free and voluntary act and deed, and as the free and voluntary act and deed of such corporation, for the uses and purposes therein set forth.

In witness whereof I have hereunto set my hand and official seal, on this the 23rd day of January, 1914.

(Signed) B. H. BOLES,
Notary Public.

[SEAL.]
My commission expires March 10, 1915.

STATE OF OKLAHOMA,
Oklahoma County, ss:

Before me, Frank B. Lucas, a notary public within and for said county and State, on this the 26th day of January, 1914, personally appeared Lee Cruce, to me known to be the person who subscribed the name of the commissioners of the land office of the State of Oklahoma to the foregoing instrument, as its chairman, and acknowledged to me that he executed the same as his free and voluntary act and deed, and as the free and voluntary act and deed of such commissioners of the land office, for the uses and purposes therein set forth.

93 In witness whereof I have hereunto set my hand and official seal, on this the 26th day of January, 1914.

(Signed) FRANK B. LUCAS,
Notary Public.

[SEAL.]
My commission expires January 3rd, 1915.

Thereupon the witness Durant identified a record of the minutes of the actions of the commissioners of the land office at a meeting held on January 16, 1919, to December 30, 1919, a portion of which minutes of a meeting of February 4, 1919, was offered and introduced in evidence as follows:

Offers in evidence

Re oil & Gas: In the matter of the oil and gas lease held by the Coronado Oil and Gas Company, covering the northeast quarter (NE. ¼); south half of northwest quarter (S. ½ of NW. ¼); southwest quarter, and south half of southeast quarter (S. ½ of SE. ¼), section 16, township 21 north, range 8 east, Pawnee County, which lease had expired on January 17, 1919. The appraisement of the physical property on said lease having been heretofore approved by the commissioners of the land office, and the parties holding said lease now asking that the same be advertised at once for re-lease in order that they might offer a bid to obtain a commercial lease thereon and continue to operate said property. After explanations by Mr. R. L. Lunsford, president of the Coronado Oil & Gas Company, and W. A. Durant, special agent oil & gas division, and after discussion by the board, it was moved by Mr. Wilson, and seconded by Mr. Carter that said above described property be and the same is hereby ordered advertised under the preference right for re-lease for oil and gas purposes. Motion prevailed.

The witness Durant thereupon identified a record of the minutes of a meeting of the commissioners of the land office, held on March 18, 1919, of which the following portion was offered and introduced in evidence by petitioner:

Re oil & gas (opening of bids): In the matter of opening
94 bids of oil and gas pursuant to advertisement, as hereinafter set out for the awarding of oil and gas leases, the tracts upon which bids are to be received having been advertised, the sums together with the accompanying descriptions are herebelow set out, which are as follows: (List of lands accompanies each bid.)

Hereupon, it being 3.00 p. m., the hour at which said bids were advertised to be received and opened on public lands set out for oil and gas purposes, it was duly moved and seconded that said bids be received, which motion was unanimously carried, and the bids by the respective bidders were tendered and received, and it appearing that all persons desiring to bid had handed in their bid, announcement being made that the receiving of bids was about to be closed, and no response being made, it was thereupon further moved and seconded that the receiving of bids be and the same is hereby ordered closed.

All vote aye: Motion prevailed.

Bid of the Coronado Oil & Gas Company of Cleveland, Oklahoma, accompanied by a certified check in the sum of one thousand ($1,000.00) dollars on tract No. 2 (as advertised) being the south half of northwest quarter (S. ½ NW. ¼); southwest quarter (SW.

¼); northeast quarter (NE. ¼) and south half of southeast quarter (S. ½ SE. ¼) of section 16, township 21 north, range 8 east, Indian meridian, Pawnee County, Oklahoma, bonus offered being four hundred and eighty ($480.00) dollars, or one dollar ($1.00) per acre.

Bid of the Uncle Sam Oil Company, of Kansas City, Kansas, accompanied by certified check in the sum of one thousand ($1,000.00) dollars on tract Number 1 (as advertised), being the west half of southwest quarter (W. ½ of SW. ¼) and southeast quarter of southwest quarter (SE. ¼ of SW. ¼) of section 16, township 21 north, range 7 east, Indian meridian, Pawnee County, Oklahoma, bonus being a hundred and twenty dollars ($120.00) or one dollar ($1.00) per acre.

Whereupon it was moved by Mr. Wilson and seconded by Mr. Carter, that the bid of above named companies be accepted and the secretary is hereby directed to grant a renewal of lease to each of said bidders, the lease to be dated from the expiration of old lease.

All vote aye: Motion prevailed.

95 Thereupon the witness Durant testified, as secretary of the commissioners of the land office, and as custodian of the records, that he was in possession of the lease which was executed by the commissioners of the land office pursuant to the foregoing resolution and said lease was produced, identified, offered, and introduced in evidence by petitioner and is as follows:

Offer in evidence

THE STATE OF OKLAHOMA:

Oil and gas mining lease

T-2. 3-18-19

This indenture of lease, made and entered into in duplicate on this the 18th day of March, A. D. 1919, by and between the commissioners of the land office of the State of Oklahoma, acting for and in behalf of the State of Oklahoma, parties of the first part, hereinafter designated as lessor, and Coronado Oil and Gas Company, Cleveland, Oklahoma, party of the second part, hereinafter designated as lessee, under and in pursuance of the provisions of the constitution and laws of the State of Oklahoma, relating to the segregation of the oil and gas deposits and the leasing thereof on school and other public lands belonging to the State of Oklahoma, witnesseth:

I, the lessor, for and in consideration of four hundred & eighty no/100—($480.00) dollars, the receipt whereof is hereby acknowledged, and of the royalties, covenants, stipulations, and conditions hereinafter contained and hereby agreed to be paid, observed, and performed by the lessee and his lawful assigns, does hereby demise, grant, lease, and let unto the lessee for the term of five years from the date hereof, and as long thereafter as oil or gas or either of them

is produced in paying quantities, all the oil deposits and natural gas in or under the following described tract of land lying and being within the county of Pawnee, in the State of Oklahoma, to-wit:
Northeast (NE. ¼) quarter; south half of northwest (NW. ¼) quarter, south half (S. ½) of the southeast (SE. ¼) quarter and the southwest (SW. ¼) of section (16), township twenty-one (21)
96 north range 8 east, I. M., and containing 480 acres, more or less, with the exclusive right to prospect for, extract, pipe, store, and remove oil and natural gas, and to occupy and use only of the surface of said land as may reasonably be necessary to carry on the work of prospecting for, extracting, piping, storing, and removing such oil and natural gas. Also the right to obtain from wells or other sources on said land by means of pipe lines or otherwise, a sufficient supply of water to carry on said operations except the private wells or ponds of the surface owner or lessee, and also the right to use, free of cost, oil and natural gas as fuel so far as necessary to the development and operation of said property.

2. The lessee hereby agrees to deliver or cause to be delivered to the commissioners of the land office of the State of Oklahoma, or their successors, a royalty, of one-eighth part of the oil or gas produced from the leased premises or in lieu thereof pay to the State the market value of said royalty interest, as the commissioners may elect. All oil and gas due to the State under this contract, shall be delivered by the lessee herein, free of cost, into pipe lines, tanks, or cars, or settled or paid for before removing same from the premises if handled in any other way. The lessee shall furnish to the lessor certified copies of gauge tickets, sales, shipments, and amount of gross production at their office in Oklahoma City. Gas to be metered on the premises under high pressure, unless some other method of gauging and metering same shall be hereafter agreed upon by the parties hereto in writing.

3. The lessee shall exercise diligence in sinking wells for oil and natural gas on the land covered by the lease, and shall drill a sufficient number of wells to offset the wells upon adjoining contiguous premises, said offset wells to be commenced within ten days after completion of any producing well upon such adjoining contiguous premises, unless a different time is prescribed by notice in writing from the lessor, and be prosecuted diligently and continuously until completed; and the said lessee shall operate the leased premises for oil and gas to same extent as individual and corporate
97 premises are being operated within the general oil and gas fields where such land is located, and failure to faithfully comply with this provision shall be cause for forfeiture of this lease to the State.

At least one well producing oil or gas in paying quantities shall be drilled and completed within one year from the date hereof, or failing so to do the lessee shall pay to the lessor for each whole year the completion of such well is delayed, for not to exceed five years from the date hereof, in addition to the other consideration named

herein, a rental of one ($1.00) dollar per acre, payable annually, in advance, and if the lessee shall fail to drill at least one such well within such yearly period, and shall fail to surrender this lease on or before the end of any such year during which the completion of such well is delayed, such failure shall be taken as conclusively evidencing the election and covenant of the lessee to pay the rental of one ($1.00) dollar per acre for such year, and thereupon the lessee shall be absolutely obligated to pay such rental. The failure of the lessee to pay such rental before the expiration of fifteen (15) days after it becomes due at the end of any yearly period during which a well has not been completed, as herein provided, shall be a violation of one of the material and substantial terms and conditions of this lease and be cause for cancellation thereof, but such cancellation shall not in any wise operate to release or relieve the lessee from the covenants and obligations to pay such rental or any other accrued obligation. It being understood that the completion of one well, producing oil or gas in paying quantities during the life of this lease, shall relieve the lessee of all future liability for said $1.00 per acre hereunder, but the lessee shall, nevertheless, remain obligated to drill an offset, or necessary offsets, and other wells necessary to the proper development and operation of said lease as herein otherwise provided; and provided further that unless a producing well of oil or gas is completed on the above-described premises within five years from the date hereof this lease shall be void.

4. The lessee shall carry on the development and operation in a workmanlike manner; commit no waste on said land, and suf-
98 fer none to be committed upon the portion in his occupancy or use; take good care of the same, and promptly surrender and return the premises upon the termination of this lease to the lessor, or to whomsoever shall be lawfully entitled thereto, unavoidable casualty only excepted.

All tools, derricks, boilers, boiler houses, pipe lines, pumping and drilling outfits, tanks, engines, and machinery, and the casing of all dry or exhausted wells, shall remain the property of the lessee and may be removed at any time prior to or at the termination of the lease by forfeiture or otherwise; and the lessee shall not permit any nuisance to be maintained on the premises; and shall not use said premises for any purposes than those authorized in the lease; and before abandoning any well, shall securely plug the same so as to effectually shut off all water from the oil-bearing stratum, or in the manner required by the laws of the State of Oklahoma.

5. The lessee shall keep an accurate account of all oil and gas mining operations, including a log of each well drilled, duly sworn to by the contractor or driller, which shall be filed with the secretary to the commissioners of the land office within thirty days after said well is completed. Accurate and reliable information concerning all wells and their operation and management shall be furnished to the commissioners of the land office or their representatives upon demand. The said lessee shall also keep an accurate account show-

ing the sales, prices, dates, purchases, and the whole amount of oil and gas mined or removed, and all sums due as royalties shall be a lien on the implements, tools, and movable machinery or personal chattels used in operating said property, and also upon all the unsold oil and gas obtained from the land herein leased as security for the payment of said royalties.

6. The lessee shall be liable to the surface owner or surface lessee for all damages or loss accruing to the surface interests in said land, and to all crops and improvements thereupon and appurtenances and hereditaments thereunto belonging by reason of the oil or gas mining operations hereunder, and in the event the amount of such damage cannot be agreed upon by the lessee hereof and such surface owner or lessee, then the amount of such damage shall be determined as is or may be provided by law. The lessee hereof further agrees to pay all such damages within ten days after the amount thereof is determined and the amount of such damages may be recovered from the lessee hereof and his sureties upon the bond given to secure the faithful performance of this lease.

99

7. This lease shall be subject to the constitution and laws of the State of Oklahoma and the rules and regulations of the commissioners of the land office now or hereafter in force relative to such leases; all of which are made a part of condition of this lease; provided, that no regulations made after the execution of this lease affecting either the length of the term hereof, the rate of royalty, or payment hereunder or the assignment hereof, shall operate to affect the terms and conditions of this lease.

8. No transfer or assignment of this lease or any part thereof, shall be valid, or convey any right in the assignee without the consent in writing of the commissioners of the land office; and such assignee shall furnish a bond to the satisfaction of the commissioners of the land office, conditioned for the faithful performance of the covenants and conditions of this lease, and pay an assignment fee of five dollars.

9. Before this lease shall be in force and effect the lessee shall give a good and sufficient bond in the sum of two thousand & no/100 ($2,000.00) dollars, to be approved by the commissioners of the land office, for the faithful performance of this lease.

10. Upon the violation of any of the substantial terms or conditions of this lease, the commissioners of the land office shall have the right at any time after hearing upon ten days notice, given by registered mail to the last known address of such lessee, or by posting notice in writing in a conspicuous place upon the said premises, specifying the terms or conditions violated, to declare this lease, null and void; and the said commissioners for and on behalf of the State of Oklahoma, shall be entitled to recover from the lessee's bondsmen, all rents, royalties, charges, claims of every kind and nature due and owing and accruing and arising out of and by

reason of this lease, on failure to comply with the provisions
100 thereof, and the lessors shall be entitled and authorized to take immediate possession of the land.

11. It is further agreed that for any refinery of crude oil and its products and byproducts, owned and controlled by the State of Oklahoma, the State shall have the preference right to purchase and receive the output from said premises at the market price thereof; provided, that this clause shall not prevent the lessee from selling the output of said leases to any person, firm or corporation whatsoever until notice in writing from the commissioners of the land office shall be served on the lessee that the State is ready to take such oil and gas or either of them under this proviso shall be valid and binding.

12. The lessee may at any time hereafter surrender and wholly terminate this lease upon payment of the rentals and other liabilities then accrued and due hereunder, and may exercise such right by filing a formal relinquishment and release of the said lease with the secretary to the commissioners of the land office; provided, that if such lease has been recorded, by causing the release thereof to be filed and recorded in the proper recording office, and upon a compliance with these requirements such lessee shall thereby be relieved from liability for rental thereafter accruing.

13. The surface owner or lessee of the said premises shall have gas free of cost from any well on said premises for domestic use thereon by making his own connection with the well.

In witness whereof the parties hereunto subscribed their signatures on the day and year first above written.

THE COMMISSIONERS OF THE LAND
OFFICE OF THE STATE OF OKLAHOMA,

(S.) J. B. A. ROBERTSON,
Governor and Chairman.

Attest:

(S.) A. S. J. SHAW,
Secretary to the Commissioners of the Land Office.

CORONADO OIL & GAS COMPANY,
Lessee,

By R. L. LUNSFORD,
President.

Attest:

J. B. MYERS, *Treas.*

101 STATE OF OKLAHOMA,
Oklahoma County, ss:

Personally appeared before me, the undersigned notary public within and for said county and State, J. B. A. Robertson, to me known to be the person who subscribed the name of the commissioners of the land office of the State of Oklahoma to the foregoing instrument, as its chairman, and acknowledged to me that he executed the same as his free and voluntary act and deed, and as the free and

voluntary act and deed of such commissioners of the land office, for the uses and purposes therein set forth.

In witness whereof I have hereunto set my hand and notarial seal on this 21st day of March, 1919.

My commission expires Aug. 18, 1920.

[SEAL.] LILLIAN A. DOWNS,
Notary Public.

Acknowledgement for corporation

STATE OF OKLAHOMA,
Oklahoma County, ss:

Personally appeared before me the undersigned notary public within and for said county and State, K. L. Lunsford, to me known to be the identical person who signed the name of the Coronado Oil and Gas Company to the above and foregoing instrument as its president, and acknowledged that he executed the same as his free and voluntary act and deed, and as the free and voluntary act and deed of the said corporation for the uses and purposes therein set forth.

In witness whereof I have hereunto set my hand and notarial seal on this 21st day of March, 1919.

[SEAL.] LILLIAN C. DOWNS,
Notary Public.

My commission expires Aug. 18, 1920.

The witness Durant thereupon testified:

Under the rules and regulations of the school land department the lessee in an oil and gas lease of the character just introduced in evidence is required to give a bond. A bond was given by the lessee in connection with the lease just introduced in evidence and I have the bond.

102 Whereupon the bond referred to by witness was produced, identified, offered, and introduced in evidence, and reads as follows:

Offer in evidence

Oil and gas bond

STATE OF OKLAHOMA,
Pawnee County, ss:

Know by all these presents, that we, Coronado Oil and Gas Company, a corporation organized and existing under the laws of the State of Oklahoma as principal, and Southern Surety Company, a corporation organized and existing under the laws of the State of Iowa as surety, are held and firmly bound unto the State of Oklahoma in the sum of two thousand ($2,000.00) dollars, for the payment of which amount we hereby bind and obligate ourselves, successors, and assigns by these presents.

The conditions of the above obligations are such that if the above Bounden Coronado Oil & Gas Company, its successors and assigns, or either of them, do and shall well and truly in all things perform faithfully and keep each and all of the covenants, conditions, and agreements specified and contained in a certain oil and gas lease made and executed on the 17th day of January, A. D. 1919, and expiring on the 17th day of January, A. D. 1924, by and between Coronado Oil and Gas Company and the commissioners of the land office, of the State of Oklahoma for and on behalf of the State, covering the following land to wit: Within the county of Pawnee, Oklahoma: Northeast (NE. ¼) quarter; south half of northwest (NW. ¼) quarter; south half (S. ½) of the southeast (SE. ¼) quarter and the southwest (SW. ¼) quarter and the southwest (SW. ¼) quarter of section sixteen (16), township twenty-one (21) north, range eight (8) E., I. M.; containing 480 acres, and which said lease is on file in the office of the secretary of the commissioners of the land office of the State of Oklahoma and is hereby referred to and made a part hereof, which on the part of the said Coronado Oil & Gas Company ought to be performed, fulfilled, and kept according to the true meaning and intent of the same, then the above obligation is to be void, otherwise to remain in full force and effect.

103 In witness whereof we have hereunto set our hands this 21st day of March, A. D. 1919.

CORONADO OIL & GAS COMPANY,
Principal,

By R. L. LUNSFORD,
President.

Attest:

J. B. MYERS, *Treas.*

SOUTHERN SURETY COMPANY,
Surety.

By L. N. BEADLES,
Attorney-in-Fact.

Attest:

_____,
Secretary.

Approved.

J. B. A. ROBERTSON.

Thereupon said witness further testified:

The school land covered by the above lease from the school land commissioners to the Coronado Oil and Gas Company, introduced in evidence, has never been sold by the State and the lease upon it is still in force.

Thereupon the witness Durant identifies minutes of the meeting of the commissioners of the land office of March 18, 1919, and the same are offered and introduced in evidence by the petitioner, as follows, to wit:

Offers in evidence

Re oil & gas: In the matter of the lease awarded to the Colorado Oil & Gas Company, of Cleveland, Oklahoma, covering the south half of the northwest quarter (S. ½ of NW. ¼); southwest *southwest* quarter of northeast quarter (SW. ¼ NE. ¼), and south half of southeast quarter (S. ½ of SE. ¼), section 16, township 21 north, range 8 east, Indian meridian; it was moved by Mr. Wilson and seconded by Mr. Carter that Mr. Durant, special agent oil & gas division, go over above land and take up the matter with reference to drilling an offset on above lease, and report to the board whether or not another well should be drilled.

All vote aye: Motion prevailed.

104 The same witness thereupon identified a record of the minutes of meetings of the commissioners of the land office from October 15, 1915, to March 16, 1916, and testified that there are five members of the commissioners of the land office, and identified the minutes of a meeting of the commissioners of the land office held on February 24, 1916, a portion of which was introduced and read in evidence by the witness as follows, to wit:

"Whereas, under oil and gas leases granted prior to December 3rd, 1915, and in certain lease contracts entered into between the commissioners of the land office and oil and gas leases on forms other than Form-1-Atty. Genl.-1915, no specific provision is made for appraising the costs of drilling producing wells; and whereas, the omission of such specific provision hinders the development of the lands so leased for oil and gas purposes up to the date of the expiration thereof; and whereas, it is to the best interests of the State that the fullest possible development of the said lands be had throughout the life of such lease:

"Be it resolved by the commissioners of the land office that the following rule and regulation be and the same is hereby promulgated:

"If oil or gas is being produced in paying quantities from any premises heretofore leased, three months before the expiration of the term of said lease, the property of the lessee hereinafter mentioned shall be appraised and the said premises shall be advertised for release for another term of five years to commence at the expiration of the said existing lease. If at any time within three months of the expiration of any existing oil and gas lease, but more than sixty days prior thereto, either party to the said lease shall so request the other in writing, then the casings, derricks, boilers, power houses, power plants, tanks, lines, tubing, rods, pumping, and drilling outfits, engines, and machinery, tools and all other appliances, and equipment used and reasonably required in the development and operation of the leased premises shall be appraised at the fair and reasonable value thereof by appraisers, one to be appointed by the commissioners of the land office and one by the lessee or his lawful

assigns. The two appraisers so appointed shall before
105 making the appraisement appoint a third person and the appraisement of the majority of said three appraisers shall be binding upon the parties to said lease, and the said appraisers, in addition to the fair cash value of the property aforesaid, shall allow to the lessee or his assigns a fair, just and reasonable compensation for the cost and expense of drilling each well then producing oil or gas in paying quantities and of each uncompleted well, but no compensation shall in any event be allowed for any dry or abandoned well or completed well or the equipment thereof not then producing oil or gas in paying quantities. In advertising said land for release for a subsequent term of five years, the appraised value of said property of the lessee and of the improvements aforesaid shall be stated in said advertisement and any bidder other than the lessee herein named or his assigns shall be required, in addition to the cash bonus bid, to deposit a sum of money or certified check payable to the lessee, or his assigns, equal to said appraised value, with the commissioners of the land office.

"The lessee or his lawful assigns shall have three days, or such further time as the commissioners of the land office may grant, after the bids for a new lease are opened and the highest bidder determined by the said commissioners, in which to exercise his preference right to re-lease said premises. If the lessee or his assigns shall fail and neglect in such time to exercise such preference right and to enter into a good and sufficient contract and give such bond as may be required for such lease for an additional period of five years, then the commissioners of the land office may award the lease to such successful bidder and shall deliver the money or certified check as deposited to the lessee hereunder or his lawful assigns, and such successful bidder shall thereupon become the owner of all such casings, derricks, boilers, power houses, power plants, tanks, lines, tubing, rods, pumping and drilling outfits, engines and machinery and tools, and all other appliances and equipment, and as against the lessee and his assigns, shall be entitled to the immediate possession of the same and of said premises, and of the oil and gas thereafter produced therefrom.

"Resolved, further, that this rule and regulation shall have all
the binding force and effect of an agreement entered into
106 between the commissioners and any lessee under any lease
contract executed upon any form other than said Form 1-Atty. Genl.-1915, upon the acceptance of the same by such lessee or his assigns, such acceptance to be in writing and filed with the secretary of this board within sixty days from the date of the adoption hereof or such further time as the board may by resolution grant."

Thereafter the same witness identifies a supplemental agreement entered into between the Coronado Oil and Gas Company and the commissioners of the land office on the 17th day of January, 1917, which was offered and introduced in evidence by the petitioner and is as follows:

Offer in evidence

Supplemental agreement

STATE OF OKLAHOMA,
County of Oklahoma, ss:

Whereas, heretofore on, to wit: the 17th day of January, A. D. 1914, the commissioners of the land office of the State of Oklahoma, made and entered into a certain oil and gas mining lease to the Coronado Oil and Gas Company, of Cleveland, Oklahoma, covering the following described real estate and premises situated in the county of Pawnee, State of Oklahoma, to wit:

"The south half of the northwest quarter, the northwest quarter, the northeast quarter and the south half of the southeast quarter of section sixteen (16), township twenty-one north (21 N.), range eight (8) east," which said lease was for a term of five years and provided for a royalty of 50 per cent of all oil and gas produced and sold from the fifteen wells then in operation upon said premises, and

Whereas, the said lease contract did not provide for the drilling of additional wells, and

Whereas, owing to the small production in that locality by reason of the territory being heavily drained by adjacent wells by reason of long operation and by reason of such conditions the commissioners of the land office at a meeting held December 6, 1916, adopted and approved the following recommendation:

"With reference to the application of Coronada Oil and Gas Company, of Cleveland, Oklahoma, who hold oil and gas lease
107 on portions of section 16, township 21 N., range 8 east, Pawnee County, Oklahoma, to drill additional wells on this lease at a reduced royalty of 12½ per cent. I am herewith submitting the following recommendation: That they be allowed to drill additional wells at a royalty of 12½ per cent for the reason that there are locations on this lease that ought to be drilled as our school section is now being heavily drained by wells on adjoining lands which are located along the lines of our school section and are as near to the section lines as they can be drilled. A portion of the derricks of the wells on the adjoining lands are setting in the road and the wells are right up against the section line. The wells on the school section are back from the line about 500 feet and room for a diagonal location between the wells on the school section and the wells on the adjoining lands. The Coronado Oil & Gas Company can not afford to drill additional wells at a royalty of 50 per cent, therefore, I believe the royalty on the new wells drilled should be reduced to 12½ per cent as there is no possibility of getting any big wells for the reason that the lands have been heavily drained. I further recommend that the locations for these new wells be made by this department so that they will not interfere with the wells which are not producing and on which the State is now getting 50 per cent

royalty, and also that they be located so that they will more effectually offset wells on adjoining premises.

"It was moved by Mr. Wilson and seconded by Mr. Gault that the recommendation of the special agent be, and the same is hereby, ordered approved, that the said Coronado Oil and Gas Company be allowed to drill additional wells at a royalty of 12½ per cent, provided however, that said location shall be made by this department, and the special agent, T. J. Ellis, jr., is hereby authorized and directed to locate all said additional wells for this department; it being understood that this order allowing additional wells to be drilled at a 12½ per cent royalty in no wise affects the royalty upon the wells already drilled and producing.

"All vote aye; motion prevailed."

Now, therefore, in consideration of the above stipulations the parties hereto agree to the conditions therein contained and set out.

108 In witness whereof the parties hereunto subscribe their signatures the day and year first above written.

COMMISSIONERS OF THE LAND OFFICE
OF THE STATE OF OKLAHOMA,
By R. L. WILLIAMS,
Governor and Chairman.

Attest:
[SEAL.]
F. A. SMITH,
Secretary to Commissioners.

CORONADO OIL & GAS COMPANY,
By G. W. SUTTON,
President.

Attest:
[SEAL.]
GEO. W. REYNOLDS,
Secretary Coronado Oil & Gas Company.

The witness Durant then testified:

I was born in the territory now comprised in the State of Oklahoma and have lived in the State sixty-one (61) years. I am familiar with the tracts of land about which I have been testifying. They are situated in Pawnee County in what formerly constituted Oklahoma Territory and have been in possession of the commissioners of the land office through its lessees and have been regulated and supervised by the commissioners of the land office since the beginning of the State.

On cross-examination the witness Durant further testified:

It is the custom of the land office with respect to the execution of leases never to execute and deliver a lease until the bond is filed by the lessee and approved.

On redirect examination the witness further testified:

In case leases are assigned the assignee is required to give a bond. It is an ordinary occurrence for a lease to be awarded to a bidder and upon the direction of the successful bidder the lease is executed

to some one else. In that event the bond is executed by the person who executes the lease.

109 Thereupon certain sections and part of sections and provisions of the enabling act adopted by Congress and approved by the President on June 16, 1906, chapter 3335, United States Statutes of 1905 and 1906, part 1, page 267, were offered, introduced, and read in evidence by the petitioner as follows:

Offers in evidence

"SECTION 7. That upon the admission of the State into the Union, sections numbered 16 and 36, in every township in Oklahoma Territory, and all indemnity lands heretofore selected in lieu thereof, are hereby granted to the State for the use and benefit of the common schools: *Provided*, That sections 16 and 36 embraced in permanent reservations for national purposes shall not at any time be subject to the grant nor the indemnity provisions of this act, nor shall any lands in Indian, military, or other reservations of any character, nor shall land owned by Indian tribes or indiyidual members of any tribe be subjected to the indemnity provisions of this act until the reservations shall have been extinguished and such lands be restored to and become a part of the public domain: *Provided*, That there is sufficient untaken public land within said State to cover this grant: *And provided*, That in case any of the lands herein granted to the State of Oklahoma have heretofore been confirmed to the Territory of Oklahoma for the purposes specified in this act, the amount so confirmed shall be deducted from the quantity specified in this act.

"SECTION 8. * * * Where any part of the lands granted by this act to the State of Oklahoma are valuable for minerals, which term shall also include gas and oil, such lands shall not be sold by the said State prior to January 1, 1915; but the same may be leased for periods not exceeding five years, by the State officers duly authorized for that purpose, such leasing to be made by public competition after not less than thirty days advertisement in the manner to be prescribed by law, and all such leasing shall be done under sealed bids and awarded to the highest responsible bidder. The leasing shall require and the advertisement shall specify in each case a fixed royalty to be paid to the successful bidder, in addition to any bonus offered for the lease, and all proceeds from leases shall be cov-
110 ered into the fund to which they shall properly belong, and no transfer or assignment of any lease shall be valid or confer any right to the assignee without the consent of the proper State authorities in writing: *Provided, however*, That agricultural lessees in possession of such lands shall be reimbursed by the mining lessees for all damage done to said agricultural lessees' interest therein by reason of said mining operations. The legislature of the State may prescribe additional legislation governing such leases not in conflict herewith."

Thereupon was offered, introduced, and read in evidence by the petitioner the ordinance irrevocably adopted by the constitutional convention of the State of Oklahoma in 1907, accepting the enabling act, which is as follows:

Offer in evidence

"Be it ordained by the constitutional convention for the proposed State of Oklahoma, that said constitutional convention do, by this ordinance, irrevocably, accept the terms and conditions of an act of the Congress of the United States entitled 'An act enabling the people of Oklahoma and the Indian Territory to form a constitution and State government and be admitted into the Union on an equal footing with the original States; and to enable the people of New Mexico and of Arizona to form a constitution and State government and be admitted into the Union on an equal footing with the original States,' approved June the 16th, A. D. 1906."

Thereupon is offered, introduced, and read in evidence by petitioner section 1, article 11, of the constitution of the State of Oklahoma (erroneously described in transcript as article 3), as follows:

Offer in evidence

"The State hereby accepts all grants of land and donations of money made by the United States under the provisions of the enabling act and any other acts of Congress for the uses and purposes and on the conditions for which same are granted or donated, and the State also hereby pledges itself to preserve such lands or moneys and all moneys derived from the sale of said lands as a sacred trust to keep same for the use and purposes for which they were granted or donated."

111 Thereupon is offered, introduced, and read in evidence by petitioner an act entitled:

Offer in evidence

"An act to authorize the commissioner of the land office to lease public lands for oil and gas purposes," approved by the Governor of the State of Oklahoma, May 26, 1908, and to be found at page 490 of the Session Laws of Oklahoma, 1907–08, which is as follows:

Be it enacted by the people of the State of Oklahoma:

SECTION 1. When any tract of the school and other public lands, granted to the State of Oklahoma under the act of Congress known as the "enabling act" is, by the commissioners of the land office of the State, known to contain oil or gas, or where such lands are, by said commissioners, deemed valuable for oil and gas purposes, such commissioners shall enter of record in their office, their finding, declaring that such oil or gas character exists, and further declaring that the oil and the gas deposits are segregated from the surface use and interest therein, and such segregation of such deposits shall

conclusively withhold the same from sale, lease or other alienation, except as provided in this act.

SECTION 2. Each agricultural, timber, grazing, or other lease to any surface interest in the deposits segregated, as provided in section one hereof, and further reserve to the State and its lessees and grantees the right to drill and operate for oil and gas wells on such premises, and the easement use and right of way to enter upon and fully enjoy the mining right reserved in this act.

SECTION 3. The oil and gas interest described in this act in such lands may be leased by the commissioners of the land office for oil and gas purposes to the same extent and in the same manner as a private owner of lands in fee could, in his own right, execute a grant thereto, subject, however, to the following limitations:

First. For a period not exceeding five years, with suitable provisions for preference right to release for a second term of five (5) years at its expiration, at the maximum rate of rentals, royalties, and bonuses that may be obtained therefor, at the time of such renewal.

112 Second. Upon due advertisement and public notice of not less than thirty days, in such manner as such commissioners may, by rule, prescribe.

Third. Such leasing shall be done under public bids and awarded to the highest responsible bidder; provided, the commissioners of the land office shall have power to reject any and all bids.

SECTION 4. The lease contract of the State, with any lessee for oil and gas purposes, shall stipulate, and the advertisement for bids for leasing such land shall specify a fixed royalty, to be determined by the commissioners of the land office, and in no event less than 12½ per centum of the total output of such oil and gas, and in addition thereto any bonus offered for such lease, and shall also require a deposit of sufficient earnest money in the hands of such commission as such commission may require to accompany each bid, with appropriate conditions of forfeiture for failure to comply with the terms and conditions of bidding upon such lands. All leases for oil and gas provided in this act shall contain a provision requiring the lessee to drill a sufficient number of wells upon the leased premises to offset the wells upon adjoining contiguous premises, and a further provision that a failure to faithfully operate the leased premises for oil and gas to as full an extent as individual and corporate premises are being operated within the general oil and gas field where such land is located, shall forfeit such lease to the State. No transfer of assignment of any lease shall be valid or convey any right in the assignee without the consent in writing of the commissioners of the land office. The board of land office commissioners shall require a good and sufficient bond for the faithful performance of said lease and may make such additional rules and regulations covering same as are not specifically provided for in this act.

SECTION 5. No lease shall be executed to, or in the interest of any pipe line or transportation company, or any company allied to, or

confederated therewith, or any subsidiary company thereof, nor any other company, corporation, person, or association under the control of either or all of them, nor to any stockholder, officer, director, agent, representative or employee, acting singly or as firms or corporations of such company, or either of them. Leases executed under
113 the terms of this act shall stipulate that, for any refinery of crude oils or its products and by-products, owned, operated, or controlled by the State, the State shall have the preference right to purchase and receive the output of such oil and gas lease at the market price thereof; provided, nothing in this act shall prevent the lessee from selling the output of said leases to any person, firm, or corporation whatsoever until notice in writing from the commissioners of the land office shall be served on the lessee that the State is ready to take such oil and gas, or either of them, and all sales of oil and gas under this proviso shall be valid and binding.

SECTION 6. Any person, firm, or corporation leasing under the provisions of this act and operating for oil and gas, shall be liable to the surface owner, the lessee or purchaser, for all damages or loss accruing to the surface interest in said land and to all crops and improvements thereunto belonging, whether said land be agricultural, timber, grazing, or otherwise.

SECTION 7. Should the lessee or owners of the surface interest and the lessee of the oil and gas interest specified in this act be unable to agree upon the damage and loss sustained by such surface lessee or owner by such lessee of the oil and gas interest therein, may condemn the same for such purpose under the law of eminent domain to like extent and in the same manner and upon the same procedure and remedies as is provided for the assessment or damages and compensation to the owner of the fee in case of condemnation for railway purposes.

SECTION 8. The commissioners of the land office shall have plenary power and authority to enter their finding of record in their office, modifying, altering or vacating any order, finding or entry, and when any tract or parcel of land shall be proven to be valueless for oil and gas purposes, or such tract of land or the oil and gas fields in which the same is situated shall become impoverished and exhausted, then such commissioners shall enter of record their finding of such non-oil and gas bearing character, or such exhausted or valueless condition for such oil and gas purposes, and when so entered of record by such commissioners, the oil and gas character of such land shall conclusively terminate. Upon premises
114 leased for oil and gas purposes, no finding or other entry of record shall be made, modifying, altering, or vacating any order, finding, or entry, previously made until notice of not less than ten days shall be given by registered mail to the last known address of such lessee, or by posting notice in writing in a conspicuous place upon the premises vacated by such new finding, order or entry.

SECTION 9. The proceeds derived in bonuses and royalties and from other inducements and considerations for the execution and operation of the oil and gas leases in this act provided, shall be carried into the several funds, for the use and benefit of which such lands were granted by the United States to the State of Oklahoma, and to the territory now comprising the area embraced within the said State under the provisions of the enabling act, and any and all other acts of Congress, for the uses and purposes, and upon the conditions and under the limitations for which the same were granted and the money resulting from such lease and from the operation thereof shall be handled, disposed of and used in like manner as the other moneys belonging to said several funds under the laws of this State.

SECTION 10. All acts and parts of acts, rules, and regulations as well as the alterable provisions of the schedule of the Constitution of the State, in conflict herewith, are modified, amended, and repealed to conform hereto.

SECTION 11. An emergency is hereby declared, by reason whereof it is necessary, for the immediate preservation of the public peace and safety that this act take effect from and after its passage and approval.

Approved May 26, 1908.

Thereupon is offered, introduced, and read in evidence by petitioner an act adopted by the Legislature of the State of Oklahoma, entitled "An act regulating the leasing of school and other public lands owned by the State for oil and gas purposes, and declaring an emergency," which is as follows:

Offer in evidence

SECTION 1. The commissioners of the land office are authorized to lease for oil and gas purposes any of the school or other lands owned by the State of Oklahoma, which such commissioners may deem valuable for oil and gas, for the term of five years and as long
115 thereafter as oil or gas may be produced therefrom in paying quantities, upon such terms and conditions and in such quantities as the commissioners shall by rules and regulations prescribe. Each such lease shall provide for the delivery to the State of a royalty of not less than one-eighth part of the oil or gas produced from the leased premises or in lieu thereof the payment to the State of the market value of said royalty interest, as the commissioners may elect. Such leasing shall be made by public competition after not less than thirty days' notice by publication in two newspapers authorized by law to publish legal notices, one of which newspaper shall be published at the State Capitol, and the other in the county where the land is situated, such leasing shall be let by sealed bids and each lease awarded to the highest responsible bidder. Such oil and gas leases may be assigned only with the consent and approval of the commissioners of the land office. Provided, that the commissioners have the right to reject any and all bids.

Empowered to segregate

SECTION 2. The commissioners are empowered to segregate any of the school or public lands for mineral purposes which the commissioners may, by order entered of record, determine to be valuable for oil, gas, or mineral purposes, and each agricultural, grazing, or other lease of the surface rights or interest in any land so segregated shall reserve to the State, its lessees, or grantees, the right to explore, drill, and operate for oil or gas on such lands, as well as the right to enter upon the said lands and enjoy the mining rights so reserved.

Term of lease

SECTION 3. All oil and gas leases executed by the commissioners of the land office shall be for a term of five years, and as long thereafter as oil or gas may be produced in paying quantities; provided, upon the forfeiture, or cancellation of surrender, or expiration of lease by reason of its termination on account of the five years' limit, provided for in the "enabling act," or any other cause, the school land commissioners shall provide for the leasing of such land in the same
116 way and in the same manner that the school land commissioners lease land which has never been leased. Provided, on such leases which are surrendered or which may expire or which have expired, the lessees or assigns shall have the value physical properties on such lease, which value shall be determined by a board of appraisers especially appointed by the school land commissioners for the appraising of physical property of leases. Provided, no physical property valuation shall be attached or considered in the making of a lease on a tract consisting of more than 640 acres. If no well shall be completed upon any leased premises within one year from the date of the lease, the lessee shall pay to the State of Oklahoma an annual rental in advance of such sum per acre as the commissioners shall prescribe in the lease, which payment shall operate to defer the completion of a well during the year for which such rental payment is made.

Provision of lease

SECTION 4. All leases for oil and gas shall contain a provision to drill one well on each leased tract within one year from the date of such lease or, on failure to complete such well, to pay an annual rental per acre as hereinbefore provided. All such leases shall further provide that the lessee shall drill a sufficient number of wells upon the leased lands, to offset all producing wells upon any adjoining or contiguous lands, and a further provision that the failure of the lessee to diligently and in good faith operate the leased premises for oil and gas to as full an extent as other lands are operated in the general oil and gas field where such leased lands is

located, shall forfeit all rights of the lessee under such lease. Each lessee shall execute a bond to the State of Oklahoma, with sureties to the approval of the commissioners, and in such sum as the commissioners shall prescribe, conditioned for the faithful performance of the provisions of the lease and for the payment of all recoverable damages which such lessee may cause to the property, crops, or rights of the surface lessee.

Each lease shall further provide that in the event the State shall at any time operate a refinery for the refining of crude petroleum, or the extraction of any of its products or by-products, the
117 State shall have the preference right to purchase and take the production or output of any such oil or gas well at the prevailing market price thereof, upon the commissioners serving written notice upon the owners of any well, of the purposes and readiness of the State to take such production.

Rules governing leases

SECTION 5. The commissioners of the land office may adopt and promulgate appropriate rules and regulations for carrying into effect the provisions of this act, but no restrictions or prohibitions against any bidder or prospective bidder shall be made other than as provided in this act.

Lessee liable—surface owners

SECTION 6. The lessee, under any oil or gas lease executed by the commissioners of the land office shall be liable to the surface owner or lessee for all injury, damage, or loss occurring to the surface interest, interest in such lands or to any building, crops or improvements, or other property, located upon or used in connection with said land.

Funds—bonuses—royalties

SECTION 7. All funds arising from bonuses, royalties, or rentals for oil and gas leases, shall be carried into and credited to the permanent funds for the use and purpose designated in the grant of such lands by Congress to the State of Oklahoma and all such funds shall be kept, handled, and used in like manner as other money belonging to said permanent funds.

Acts in conflict repealed

SECTION 8. All acts or parts of acts inconsistent herewith, are hereby repealed.

Emergency

SECTION 9. For the preservation of the public peace, health and safety, an emergency is hereby declared to exist, by reason whereof,

this act shall take effect and be in force from and after its passage and approval.

Approved this 30th day of March, 1917.

118 Thereupon the following colloquy between counsel, in open court, occurred:

Mr. HAYES. Now, I would like to have it understood and agreed, if the board pleases, that the act of 1907 and '08, the first act introduced in evidence, was in force at the time of the execution of the first lease and that the act of 1917, the second act introduced, was in force at the time of the execution of the second lease. Is that correct?

Mr. DWIGHT H. GREEN. Yes; that is correct.

Whereupon G. W. REYNOLDS, being duly sworn, testified on behalf of petitioner as follows:

"I have been Secretary of the Coronado Oil and Gas Company since it was organized in January, 1914. The company was organized to take over the school-land lease that had been bid in by Dr. Sutton and took it over immediately after the oragnization was perfected. The lease is on land 16–21–8. The Coronado Oil and Gas Company owned no other property in January, 1914, than the lease, and has owned and operated just that one lease on the school land. It had no source of income during the years 1917, '18, and '19 except the revenue from this lease. It was a developed oil and gas lease on which there were probably fifteen operating wells. The company derived its entire income during the years 1917, 1918, and '19 from the production and the sale of oil produced from the lands covered by this lease."

On cross-examination the witness Reynolds further testified:

"I was one of the incorporators of the Coronado Oil & Gas Company. As secretary of the company, I have with me the minute books of the company, which shows a copy of the articles of incorporation of the company, and which I am willing to put into evidence."

Whereupon there was introduced and read in evidence by the respondent the following from article 2 of the certificate of incorporation, which outlines the purpose of the petitioner corporation:

Offer in evidence

The purpose for which this corporation is formed are as follows:

119 To lease, hold, control, operate, and sub-lease oil, gas, coal, and other mineral lands; to prospect for oil and gas, coal, and other minerals and mine for the same; to conduct drilling and mining operations for, and to produce oil, gas, coal, and other minerals; to borrow money when necessary to advance such prospecting and operating, and to pledge, bond, and mortgage the interests of this corporation in and to such real estate, personal property, and chattels real as it may own, as security therefor; to buy, sell, convey, and give title to and for leases, and leasehold estates for oil, gas,

coal, and other mineral properties, and to own and hold said power plants, pumping stations, and plants for oil, gas, and water; to buy, sell, and trade, refine, work in, and utilize, refined and crude oil and its various products, gas, and coal and their products, and other minerals and their products and to do all things whatsoever that it might or could do under and by virtue of the laws of the State of Oklahoma, and such other State or States as it may in the future operate and forward and promote any and all other purposes herein set forth.

Thereupon the same witness further testified on cross-examination: There is no particular reference in the articles of incorporation to this particular leasehold that has been described and about which evidence has been introduced here. There is no particular reference in any article of the articles of incorporation referring to this particular leasehold or particular tract of land. I considered that the company had the power to procure leases and go into the oil business anywhere it could get them. As organizer of this company, I did not put any money into it. I did own some shares of stock in it at first, but do not now. I did not pay anything for those shares. One share was carried in my name, just enough to qualify me as director.

Thereupon counsel for both petitioner and respondent stated they had no further evidence to present and rested their case. The foregoing is the substance of all the evidence introduced at the trial of said proceeding.

120 Petitioner agrees that the amount of gross income and net income of petitioner for the years 1917, '18, and '19 as found by the Board of Tax Appeals, and the amounts of deficiency taxes for said years, respectively, as determined by the Board of Tax Appeals are correct, if it be determined that the income of petitioner, derived and received during said years from the production and sale of oil from said oil and gas leases is subject to income and profit taxes or renders petitioner liable under the law to the payment of income and profit taxes by reason of such income.

S. W. Hayes,
T. P. Gore,
Attorneys for Petitioner.

The foregoing statement of evidence is accepted as correct and it is agreed by the respondent that the same may be settled by the Board of Tax Appeals and made part of the record in the foregoing case.

C. M. Charest,
General Counsel Bureau of Internal Revenue, Attorney for Respondent.

Order settling statement of evidence

The foregoing contains the substance of all the evidence given at the hearing of this proceeding. That the same may be preserved

and made a part of the record this statment of evidence is duly stated, approved, signed, and ordered to be made part of the record in the above entitled cause this fifth day of December, 1929.

By the board:

SUMNER L. TRUSSELL,
Member.

Now, December 9, 1929, the foregoing statement of evidence certified from the record as a true copy.

[Seal U. S. Board of Tax Appeals.]

B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

121 Before United States Board of Tax Appeals

[Title omitted.]

Præcipe for the record

Filed Dec. 5, 1929

To the Clerk of the United States Board of Tax Appeals:

You will please prepare and, within sixty days from the date of the filing of the petition for review in the above stated case, transmit to the clerk of the Court of Appeals of the District of Columbia, certified copies of the following documents:

1. The docket entries of proceedings before the United States Board of Tax Appeals in the above-entitled case.
2. Pleadings before the board.
3. Findings of fact, opinion and decision of the board.
4. Petition for review.
5. Stipulation made under and pursuant to the provision of section 1002 of the revenue act of 1926, agreeing that the decision and judgment in this case may be reviewed by the Court of Appeals of the District of Columbia.
6. Statement of the evidence as settled.
7. This præcipe for the record.
8. Notice of filing this præcipe and proof or acceptance of service thereof.

The foregoing to be prepared, certified, and transmitted as required by law and the rules of the Court of Appeals of the District of Columbia.

S. W. HAYES,
1112 Colcord Building,
Oklahoma City, Oklahoma;
T. P. GORE,
1040 Woodward Building,
Washington, D. C.,
Attorneys for Coronado Oil and Gas Company.

122 The foregoing præcipe is agreed to and no counter præcipe will be filed.

C. M. CHAREST,
General Counsel Bureau of Internal Revenue,
Attorney for Respondent.

Before United States Board of Tax Appeals

[Title omitted.]

Notice of filing præcipe

Filed Dec. 5, 1929

To C. M. CHAREST,
General Counsel, Bureau of Internal Revenue,
Washington, D. C.,
Attorney for the Respondent:

SIR: Please take notice that on the 5th day of December, 1929, we filed with the clerk of this board, a præcipe designating the portions of the record to be transmitted to the Court of Appeals of the District of Columbia on the appeal taken in the above case, a copy of which præcipe is hereto annexed and hereby served upon you.

Dated this 5th day of December, 1929, at Washington, D. C.

S. W. HAYES,
1112 Colcord Building,
Oklahoma City, Oklahoma;
T. P. GORE,
1040 Woodward Building,
Washington, D. C.,
Attorneys for Coronado Oil and Gas Company.

123 Service of the foregoing notice and copy of præcipe is hereby accepted, this 5th day of December, 1929.

C. M. CHAREST,
General Counsel Bureau of Internal Revenue, Attorney for Respondent.

Now, December 9, 1929, the foregoing præcipe, notice of filing, and proof of service certified from the record as a true copy.

[Seal U. S. Board of Tax Appeals.]

B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

[File endorsement omitted.]

124 In Court of Appeals of the District of Columbia

CORONADO OIL & GAS CO., APPELLANT
v.
COMMISSIONER OF INTERNAL REVENUE } No. 5115

Order allowing substitution, Dec. 5, 1930

On consideration of the motion filed herein to permit the above-entitled cause to be continued and maintained against David Burnet, Commissioner of Internal Revenue, successor in office of Robert H. Lucas, retired,

It is ordered by the court that said motion be, and it is hereby, granted and the substitution allowed as prayed.

125 [Minute entries of argument, April 7 and 8, 1931 omitted in printing.]

127 In Court of Appeals of the District of Columbia

CORONADO OIL AND GAS COMPANY, APPELLANT
v.
DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE } No. 5115

Appeal from the Board of Tax Appeals

Argued April 7, 1931. Decided June 1, 1931

T. P. Gore of Washington, D. C., for appellant; G. A. Youngquist, J. L. Monarch, A. D. Sharpe, and C. M. Charest, all of Washington, D. C., for appellee.

Before MARTIN, Chief Justice, and ROBB, VAN ORSDEL, HITZ, and GRONER, *Associate Justices*

Opinion filed June 1, 1931

GRONER, *Associate Justice:* This is a petition to review a decision of the Board of Tax Appeals.

By act of Congress approved June 16, 1906 (34 Stat. 267), the people of the Territory of Oklahoma were authorized to form a constitution preliminary to admission to statehood. In section 3 of the act, Congress required as a condition of admission that "provisions shall be made (in the Constitution) for the establishment and maintenance of a system of public schools, which shall be open to all the children of said State and free from sectarian control"; and, by section 7, Congress granted to the State, for the use and benefit of the common schools, the sections of land numbered 16 and 36 in every township in Oklahoma Territory, and provided (section 8) that all lands granted by the act valuable for minerals, gas, and

oil should not be sold by the State prior to January 1, 1915, but might be leased for periods not exceeding five years, the proceeds from the land so leased to be covered into the school fund. The constitution as adopted provided for the establishment of a public free-school system, and pledged the faith of the State to preserve such lands and moneys "as a sacred trust," and to keep the same for the uses and purposes for which they were granted or donated, and provision was made for an executive department, to be known as "Commissioners of Land Office," to which was given the management of the school lands and of the funds derived therefrom.

128 After admission to statehood, the legislature (Statutes of 1921, section 9415, et seq.) provided by law for the leasing of the lands containing oil and gas for a first term of five years with the right of renewal for a second term of five years at a fixed royalty to be determined by the commissioners of the land office, but in no event less than twelve and one-half per cent of the total output of such oil and gas. The conditions of the leases are prescribed by statute, and, when made, are subject to all lawful rules which the commissioners may adopt. The right of the lessee to assign is forbidden except with the written consent of the commissioners, and provision is made for a sufficient bond to secure faithful performance. The leases provide that the State under certain circumstances shall have the preference right to purchase and take the entire output of oil and gas produced at the then market value of the same.

Appellant is an Oklahoma corporation. Its entire income during 1917–18–19 was derived from its operations as a lessee of the State of Oklahoma under two oil and gas leases executed to it by the State upon portions of the public school lands of the State. Appellant agreed to pay a royalty of fifty per cent of the gross production of oil in consideration of the leasing of the land to it. The question which we have to decide is whether the income derived by appellant from the sale of its share of the oil and gas obtained from such leased lands is taxable as income under the Federal income statutes (revenue act of 1916, 39 Stat. 756; rev. act 1917, 40 Stat. 300; rev. act 1918, 40 Stat. 1057). These acts in terms include the character of income in question, but appellant insists that it is an agency or instrumentality of the State of Oklahoma for development and operation of its State school lands, and that, under the Constitution, the United States can not tax such agency or instrumentality.

Neither a State nor the United States can tax the property, governmental functions, agencies, or instrumentalities of the other, or the means by which they are exercised. "As the States can not tax the powers, the operations, or the property of the United

129 States * * *, so it has been held that the United States have no power under the Constitution to tax either the instrumentalities or the property of a State." Pollock v. Trust Co., 157 U. S. 429, 584. But it frequently happens that cases arise in which the limitation upon the taxing power of each, so far as it affects the other, must receive a practical construction which permits both

to function with the minimum of interference each with the other"—Metcalf & Eddy v. Mitchell, 269 U. S. 514, 523—and hence the limitation, as applicable to both State and Nation, has been the subject of discussion in numerous cases in the Supreme Court, and that court has adjusted the general principle to the limitation in the differing facts of each case, though in many the line of separation is sometimes so faint as to be difficult to follow, or, as Mr. Justice Stone remarked in Metcalf & Eddy v. Mitchell (p. 528), "Experience has shown that there is no formula by which that line may be plotted with precision in advance." Nothing, however, appears in any opinion to which we have had access which would indicate any distinction between State taxation of Federal agencies and Federal taxation of State agencies, except that in South Carolina v. U. S., 199 U. S. 437, where the State was shown to have engaged in a private business, an excise tax was held valid, and presumably the profits or income of the business taxable, but the decision was placed on the ground that the thing in which the State was engaged was not governmental. In many of the cases in which tax laws were held invalid, the tax was sought to be applied to some governmental activity. Bank v. Supervisors, 7 Wall. 26; Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429; Owensboro National Bank v. Owensboro, 173 U. S. 664. In other cases taxes which imposed "incidental" burdens were regarded as not impinging the general principle of exemption. Home Ins. Co. v. New York, 134 U. S. 594. But in South Carolina v. U. S. (supra), it was held that, though the State received substantial profits which were devoted to public purposes, the business was taxable. Some more recent decisions of the Supreme Court have carried the doctrine of exemption farther than it was, by many, originally thought to extend. Thus sales of commodities to the Government by a retailer have been held not [illegible] subject to excise taxes—Panhandle Oil Co. v. Mississippi, 277 U. S. 218—as has also income from royalties from the use of patents. Long v. Rockwood, 277 U. S. 142. On the other hand, in Baltimore Shipbuilding Co. v. Baltimore, 195 U. S. 375, State taxation of profits derived by a private corporation engaged in work for the Government was held valid; and in Fidelity Co. v. Pennsylvania, 240 U. S. 319, 327 was held that contracts between private corporations and the United States do not render the corporation an essential governmental agency or confer freedom from State taxation. And so it is insisted here on behalf of the Commissioner that whatever exemption the State of Oklahoma may enjoy from Federal taxation of its oil lands, this exemption does not extend to appellant because, though the State may be engaged in the business of maintaining the schools and thus in performing a governmental duty (1st Dillon on Municipal Corporations (5th Ed.), Sec. 89, 4th ed., sec. 1669; Claybrook v. City, 26 Fed. [illegible] Kahn v. Thompson, 134 N. W. 738; Frost v. School, 41 N. E. [illegible] Hamlin v. Davison, 39 Atl. 342; Howard v. Sasuma, 109 Pac. [illegible] appellant is not, but, as a private corporation, is engaged in profit-

ing and selling oil and gas; that is to say, in a private business and not a governmental activity. And so it is insisted that the imposition of the tax does not interfere with or impose a burden upon the State—that it is not a tax upon the lands or upon the oil or the gas, or the proceeds of the same which the State is entitled to receive, but is confined solely to that portion of the value of the gas and oil produced which appellant as a private corporation is entitled to have and use for its own account. In this aspect it is said that the case is much like Metcalf & Eddy v. Mitchell, supra, in which it was held that where "the tax is imposed on the income of one who is neither an officer nor employee of Government and whose only relation to it is that of contract, under which there is an obligation to furnish service, for practical purposes not unlike a contract to sell and deliver a commodity"—the tax is valid; and there is much strength and force in this argument, and, if the question were not, as we think, foreclosed, we are inclined to think we might feel impelled to adopt the view; but, as we see it, the Supreme Court has laid down the rule in Gillespie v. Oklahoma, 257 U. S. 501, and
131 Jaybird Mining Co. v. Weir, 271 U. S. 609, by which we are controlled. In the Gillespie case, the State of Oklahoma sought to impose a tax upon the net income derived by the lessee from leases of restricted Indian lands. Admittedly the lessee was an instrumentality used by the United States in carrying out their duties to the Indians, and, therefore, it was insisted the income derived by the lessee was not subject to taxation by the State. The State court held that, since the tax was not levied upon the Indians' income or share of the proceeds, the private share of the lessee was taxable. The Supreme Court reversed the State court, and Mr. Justice Holmes, speaking for the court, and quoting in part from Indian Oil Co. v. Oklahoma, 240 U. S. 522, 530, said:

"'A tax upon the leases is a tax upon the power to make them, and could be used to destroy the power to make them.' The step from this to the invalidity of the tax upon income from the leases is not long.

"In cases where the principal is absolutely immune from interference an inquiry is allowed into the sources from which net income is derived and if a part of it comes from such a source the tax is pro tanto void; Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429; 158 U. S. 601; a rule lately illustrated by Evans v. Gore, 253 U. S. 245; and applied in a case somewhat like the present by the Supreme Court of Hawaii. Oahu Ry. & Land Co. v. Pratt, 14 Hawaii, 196. Whether this property could be taxed in any other form or not, it can not be reached as profits or income from leases such as those before us. The same considerations that invalidate a tax upon the leases invalidate a tax upon the profits of the leases, and, stopping short of theoretical possibilities, a tax upon such profits is a direct hamper upon the effort of the United States to make the best terms that it can for its wards."

We are unable to observe any difference in fact, or to perceive any distinction in principle, between the Gillespie case and that under consideration. In both there were oil lands. In the one case they were held by the Federal Government for the benefit of the Indians; in the other by the State for the benefit of its school children—white and Indian. In each there was a lease on a royalty basis. In
182 each the lessee was a corporation or private person; and in each the tax imposed sought to reach alone its or his profits from the operation of the lease. It is obvious, therefore, that the only difference in the facts is that in the one case the person sought to be taxed was an instrumentality of the Federal Government, and in the other, of the State government. If the tax was invalid in the one, it seems to us it must be invalid in the other, for, as we have already seen, the two governments stand upon an equality in the right of exemption of their respective instrumentalities from taxation. Unless, therefore, there is a higher and different obligation on the Federal Government in the protection of the interests of the Indians than is on a State in the education of its youth, the principle as it applies to the one must, we think, apply equally to the other. There can be no doubt that the school lands held by the State of Oklahoma in trust for the education of the youth of that State are as immune from taxation by the Federal Government as the lands held by the Federal Government for the Indians are immune from State taxation. If, therefore, the lessee of restricted Indian lands is a governmental instrumentality, it seems to us necessarily to follow that the lessee of school lands of the State, under identical conditions, is a governmental instrumentality, and since, as the Supreme Court said in the Gillespie case, the principle that invalidates a tax upon the leases likewise invalidates a tax upon the profits of the lessee, it must follow, we think, that the income from the leases can not be taxed in the one case any more than in the other. But it was argued at the bar of this court that while the analogy of the two cases seems so nearly perfect, there is a difference growing out of the fact that the United States, being a government of restricted or granted powers, has no right to engage in private business, and therefore whatever it does is in pursuit of a governmental function, but that this is not also true of a State which is without restrictions upon its right to enter private business, and therefore, it is contended, when a State undertakes to exploit its mineral or oil lands and sell the product thereof, it enters business as much as the State of South Carolina did when it engaged in the liquor business, but we are
183 not convinced by this argument. While it may be true that United States has no right to transact private business, and while it may also be true that when it enters into competition with private business, as it has in the operations of the Shipping Board and the Housing Corporation, all its acts in connection therewith are of a governmental character, and while it may be equally true that

a State may engage in private business, the fact is that in the exploitation of oil lands, like those in this and the Gillespie case, both the State and Federal Governments are using property earmarked with a governmental purpose, in the pursuit of a duty enjoined upon each equally to create and preserve a fund in the one case for the Indians as wards of the Nation, and in the other for the school children as wards of the State. It is, we think, the purpose, rather than the thing, which controls, but if this is not correct, then the thing, i. e. the sale of the oil, is, in the case of the Federal Government, identically like that in the case of the State Government, and it can not be said that the one government can engage in what is ordinary designated commerce and insist that because of its restricted powers it is engaged in the performance of a governmental function, and deny to a State in the same circumstances the same character, or classify its identical activity, because of its less limited powers, in a different category.

Unless, therefore, there is something in group No. 1 Oil Corp. v. Collector Int. Rev., — U. S. — (April 13, 1931), which modifies or changes the principle pronounced in the Gillespie case, supra, or which limits the immunity, there declared, solely to Indian lands under administration by the Federal Government, we shall feel impelled to hold, as we indicated, that the Gillespie case controls this. The main facts in Group Oil case in relation to its background and machinery are essentially like the facts in the Gillespie case and the case now under consideration. There, as here, the dispute arose over Federal income taxes on profits derived by a private corporation from the sale of oil and gas produced under leases to it by a State (Texas). There, as here, immunity was claimed as an instrumentality of the State for the development of its public domain. There the land from which the oil was taken had been set apart for the benefit of the State university; here for the benefit of the
184 school children of the State under a constitutional provision adopted pursuant to mandate of Congress in the grant of statehood. There, as here, the grant to the corporation was designated a lease, and there, as here, the return to the State was measured by a percentage of the oil produced. The distinction or difference between the Group Oil case on the one hand and this case and the Gillespie case on the other, arises out of the fact that in Texas the constitution of that State, as interpreted by the highest court of the State "requires the legislature to dispose of university lands by sale only"—Theisen v. Robison, 117 Texas 489, 502—and accordingly it was held in that case that leases like the one in Group Oil Co. case were present sales to the lessees of the oil and gas in place without restriction and without retention of interest in the vendor or lessor; in other words, that, though denominated a lease, the transaction was in fact a sale of all the oil and gas in the particular land conveyed. And the Supreme Court in the Oil Group case,

adopting this construction of the Texas constitution as binding, held the tax valid solely on that ground. But the same thing is not true of this case, for here there not only was no sale, but a congressional prohibition—accepted by the State—against one, and instead there was a lease with an agreed division of profits in all respects like that in the Gillespie case where the tax was held invalid. And so we have to conclude, that, unless we are mistaken in thinking there is no difference in the immunity from taxation of income derived from tribal lands of Indians and immunity from taxation of income derived from school lands of a State, where the income in each case arises under the same conditions, the principle applied in the Gillespie case is applicable in this case, and the Board of Tax Appeals was wrong in holding otherwise, and its decision should be and is reversed, and the case remanded for further proceedings not inconsistent with this opinion. Reversed.

MARTIN, *Chief Justice*, dissents from the foregoing decision, upon grounds which are fully stated in the majority opinion of the Board of Tax Appeals, included in this record, and also reported in 14 B. T. A. 1214.

[File endorsement omitted.]

135 In Court of Appeals of the District of Columbia

CORONADO OIL AND GAS COMPANY, appellant
v.
DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE
No. 5115. April term, 1931

Judgment

June 1, 1931

Appeal from the Board of Tax Appeals. This cause came on to be heard on the transcript of the record from the Board of Tax Appeals and was argued by counsel. On consideration whereof, it is now here ordered, adjudged, and decreed by this court that the decision of the said Board of Tax Appeals in this cause be, and the same is hereby, reversed, and that this cause be and the same is hereby remanded to the said Board of Tax Appeals for further proceedings not inconsistent with the opinion of this court.

Per Mr. JUSTICE GRONER.

Mr. Chief Justice MARTIN dissenting.

136 In Court of Appeals of the District of Columbia

[Title omitted.]

Designation of record

Filed August 5, 1931

The clerk will prepare a transcript of record in the above-entitled case, including the following:

1. Printed record.
2. Order substituting party appellee.
3. Note of argument.
4. Opinion.
5. Judgment.
6. This designation, and clerk's certificate.

CLAUDE R. BRANCH,
Acting Solicitor General,
Counsel for Appellee.

AUGUST 5, 1931.

[File indorsement omitted.]

137 [Clerk's certificate to foregoing transcript omitted in printing.]

138 Supreme Court of the United States

Order allowing certiorari

Filed October 26, 1931

The petition herein for a writ of certiorari to the Court of Appeals of the District of Columbia is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Indorsement on cover:] File No. 36155. District of Columbia Court of Appeals. Term No. 341. David Burnet, Commissioner of Internal Revenue, petitioner, vs. Coronado Oil and Gas Company. Petition for writ of certiorari and exhibit thereto. Filed September 1, 1931. File No. 36155.

U. S. GOVERNMENT PRINTING OFFICE: 1931

FILE COPY

No. 341

In the Supreme Court of the United States

OCTOBER TERM, 1937

DAVID BURNEY, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

GORONADO OIL AND GAS COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE DISTRICT OF COLUMBIA AND BRIEF IN SUPPORT THEREOF

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In the Supreme Court of the United States

OCTOBER TERM, 1931

No. —

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

CORONADO OIL AND GAS COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE DISTRICT OF COLUMBIA AND BRIEF IN SUPPORT THEREOF

PETITION

The Solicitor General, in behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Court of Appeals of the District of Columbia entered in the above case June 1, 1931 (R. 131), reversing the decision of the United States Board of Tax Appeals (R. 66).

QUESTION PRESENTED

May the United States constitutionally impose a tax upon the income of a private corporation de-

rived from sales of oil and gas produced under lease of lands owned and set apart by the State of Oklahoma for the maintenance of its common schools?

The statutes involved are set forth in the appendix, pp. 14–18, *infra*.

STATEMENT

By the Oklahoma Enabling Act Congress required, as a condition of admission into the Union, that the State should make provision in its constitution for a system of common schools, and for this purpose granted to the State sections in every township, with the proviso that such lands valuable for minerals should not be sold but might be leased for periods of five years, the proceeds to be paid to the school fund. Act of June 16, 1906, Sections 3, 7, and 8 (c. 3335, 34 Stat. 267, 270, 272, 273), p. 15, *infra*. The State, by its constitution, provided for a common-school system, and pledged its faith to preserve the lands and moneys derived from them as a "sacred trust" for the purposes for which the lands were granted. Constitution of Oklahoma, Article XI, Section 1, p. 16, *infra*. Legislative provision was then made for leasing the lands containing gas and oil, and for the payment of the proceeds into the school fund. Oklahoma Compiled Statutes 1921, Sections 9415, 9417, and 9423, pp. 16–18, *infra*.

The State leased certain lands to respondent, an Oklahoma corporation, in January, 1914, re-

making the leases (on somewhat different terms) in May, 1918. (R. 97–103.) Respondent agreed to pay the State under the first lease 50 per cent, and under the second lease 12½ per cent, of the gross production of oil and gas. (R. 97, 98.)

The Commissioner of Internal Revenue assessed income taxes upon respondent's income derived through the sale of its share of the oil and gas obtained from the leased lands during 1917, 1918, and 1919. The Board of Tax Appeals sustained the action of the Commissioner. (R. 66; 14 B. T. A. 1214.) The Court of Appeals of the District of Columbia (Martin, C. J., dissenting) reversed the decision of the Board. (R. 124.)

SPECIFICATION OF ERROR TO BE URGED

The Court of Appeals erred in holding that the United States was without power to tax respondent's income derived from the sale of respondent's share of oil and gas produced under lease of lands owned by the State of Oklahoma and set apart for the maintenance of its common schools.

REASONS FOR GRANTING THE WRIT

This case involves the extent of the implied constitutional limitation upon the power of the United States to tax agencies or instrumentalities of the States, and particularly the question whether income from sales made by a private corporation of oil taken from lands leased from a State is exempt from Federal taxation. It is common knowledge

that many States lease large tracts of State lands to private parties; that such leases are sought in the expectation of profit from the sale of ore, coal, oil, and other valuable products of the land; and that the recovery and sale of such products under leases of State lands often result in very substantial profits to the lessees. The exemption from Federal taxation of profits derived by the lessees of State lands materially affects the revenue of the United States and the case is of general importance in the administration of the Federal taxing statutes.[1]

The precise question has never been decided by this Court. It was presented and argued in *Group No. 1 Oil Corporation* v. *Bass*, 283 U. S. 279. But decision in that case was predicated upon rulings of the Supreme Court of Texas to the effect that the lease there in question was a sale of oil and gas in place. The issue is now pending before the Court of Claims in *Ernest Whitworth Marland* v. *United States*, No. K–322 (Oklahoma State oil lands), and is also before the Court of Appeals of the District of Columbia in *Bear Canyon Coal Co.* v. *Commissioner*, No. 5051 (Colorado State coal lands).

We believe the decision below is contrary to the ruling of this Court in *Forbes* v. *Gracey*, 4 Otto, 762,

[1] We have been informed by the Treasury Department that it estimates, basing such estimate on the value of oil royalties received by the States of New Mexico, Oklahoma, and Texas, that taxes aggregating about twelve million dollars are involved annually in those three States, that such sum would be increased by an increase in the price of oil, and that until decided the question here involved will arise continually from all States where public lands are leased for oil and gas production purposes.

and a departure from the principles laid down by this Court in *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514; *Gromer* v. *Standard Dredging Co.*, 224 U. S. 362; *Baltimore Shipbuilding Co.* v. *Baltimore*, 195 U. S. 375, and the cases following them, many of which are cited in the brief; and that it is the result of a misapplication of the decision of the Court in *Gillespie* v. *Oklahoma*, 257 U. S. 501.

Wherefore it is respectfully prayed that the petition be granted.

THOMAS D. THACHER,
Solicitor General.

AUGUST, 1931.

BRIEF IN SUPPORT OF PETITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 27) is reported in 14 B. T. A. 1214. The opinion of the Court of Appeals of the District of Columbia (R. 124) is not yet reported.

JURISDICTION

The judgment of the Court of Appeals was entered June 1, 1931. (R. 131.) Jurisdiction is conferred upon this Court by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED, STATUTES INVOLVED, ETC.

A statement of the question presented, specification of error, and a statement of the case will be found in the petition. The statutes involved appear in the appendix.

ARGUMENT

The United States here asserts the right to tax the income of a private corporation organized and operated solely for private profit. Respondent resists the claim on the ground that it is within the protection of the implied constitutional limitation

upon the power of the Federal government to tax instrumentalities of the States.

The contention that the respondent is an instrumentality of the government of Oklahoma finds its sole support in the fact that the State has entered into a business transaction with it. Cases are numerous where private profits more immediately connected with the business of government have been held by this Court to be within the reach of the taxing power.

In *Forbes* v. *Gracey*, 4 Otto, 762, it was held that Nevada might impose a tax on the proceeds of a mine, although the mine itself was the property of the United States and was worked by the taxpayer under a mining claim held from the United States.

In *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, it was held that fees of a consulting engineer received for services in advising a State or local subdivision as to sanitary projects were subject to the Federal income tax, because this Court could not find that the tax impaired in any substantial manner the ability of the plaintiffs in error to discharge their obligations to the State or the ability of the State to procure the services of private individuals to aid them in their undertakings; and it said, at page 522:

> * * * it is apparent that not every person who uses his property or derives a profit, in his dealings with the government, may clothe himself with immunity from taxa-

tion on the theory that either he or his property is an instrumentality of government within the meaning of the rule.

See also *Lucas* v. *Reed*, 281 U. S. 699, and *Lucas* v. *Howard*, 280 U. S. 526. In *Gromer* v. *Standard Dredging Co.*, 224 U. S. 362, this Court held that Porto Rico might tax machinery and boats engaged in dredging work in San Juan harbor in pursuance of a contract with the United States government. In *Baltimore Shipbuilding Company* v. *Baltimore*, 195 U. S. 375, it was held that a State might tax the interest of a company owning a dry dock in land conveyed to it by the United States, notwithstanding a provision in the instrument of conveyance that upon certain contingencies the property might revert to the United States, and that the United States had a continuing interest to use the dry dock to serve its purposes. In *South Carolina* v. *United States*, 199 U. S. 437, it was held that the Federal government might exact a license tax from dispensers operating liquor dispensaries established by the State of South Carolina.

In *Alward* v. *Johnson*, 282 U. S. 509, it was held that a State might levy a gross receipts tax upon the franchises and property of a bus line, although three-fourths of its revenues were earned by carrying the United States mail. In *Willcuts* v. *Bunn*, 282 U. S. 216, it was held that the United States could impose a tax upon a profit derived from a

sale by a private owner of municipal and State bonds.

In *Shaw* v. *Gibson-Zahniser Oil Corporation*, 276 U. S. 575, it was held that the State of Oklahoma might impose a tax on the gross value of oil and gas produced, although such oil and gas were produced by the taxpayer under a lease of lands owned by an Indian, and inalienable by him without the consent of the Secretary of the Interior. In *Choctaw, O. & G. Railroad Company* v. *Mackey*, 256 U. S. 531, it was held that an Oklahoma municipality might levy a special assessment for street improvements against part of the right of way and station ground of a lessee railroad company whose lessor was a corporation to which Congress had granted the right to build a railroad in Indian Territory with a branch line to coal mines leased from the Choctaw Nation. In *Thomas* v. *Gay*, 169 U. S. 264, it was held that an Oklahoma county might tax cattle grazing on Indian lands under certain leases for grazing purposes made by the Osage tribal government subject to the ratification of the Commissioner of Indian Affairs and of the Secretary of the Interior.

In *Thomson* v. *Pacific Railroad Co.*, 9 Wall. 579, it was held that a State might tax property of a railroad corporation which had been the recipient of benefits by way of subsidy from the United States, and which was bound to perform certain services for the United States. In *Railroad Company* v. *Peniston*, 18 Wall. 5, it was held that Line

coln County, Nebraska, could tax the Union Pacific Railroad Company on its property in the County, although the railroad company was a Federal corporation chartered for the purposes, among others, of carrying the mails, of transporting troops and supplies, and of performing other services for the United States. See also *Central Pacific Railroad Company* v. *California*, 162 U. S. 91.

In *Veazie Bank* v. *Fenno*, 8 Wall. 533, this Court upheld a tax on notes issued by a bank operating under a State franchise. In *National Bank* v. *United States*, 101 U. S. 1, a tax on notes issued by a municipality and used as money was upheld. In *Manhattan Co.* v. *Blake*, 148 U. S. 412, it was held that a Federal tax on the average deposits of a bank was not unconstitutional by reason of the fact that there were included moneys deposited by the treasurer of the State of New York. In *Snyder* v. *Bettman*, 190 U. S. 249, a succession tax on the transfer of property by will to a municipality was upheld.

The implied prohibition upon the United States extends only to exertions of State power of a strictly governmental nature. *South Carolina* v. *United States*, *supra*, p. 461; *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 157–158; *Ambrosini* v. *United States*, 187 U. S. 1, 7. And coupled with this is the condition that absolute immunity from Federal taxation exists only in favor of those State agencies which themselves immediately and directly execute such power. *Metcalf & Eddy* v. *Mitchell*, *supra*, p. 522.

It need not be argued that respondent's production and sale of gas and oil were not acts of government. They were merely activities incident to the carrying on of an ordinary private business. Neither their performance nor the making of the lease between respondent and the State was immediately and directly connected with the operation of the schools.

The use to which the State put the revenue it derived from the lease did not change the character of these acts from that of private business to that of sovereignty or government. The nature of an act as governmental or nongovernmental is determined by what it is in and of itself, not by what the profits it produces may be devoted to. In the *South Carolina case, supra,* the gains were paid into the public coffers to help support the ordinary activities of government, yet it was there held that persons selling liquor in dispensaries set up by the State itself were taxable by the United States; and it seems apparent that leasing oil land is no more governmental in character than the operation of dispensaries. See also *Salt Lake City* v. *Hollister,* 118 U. S. 256. Profits earned by the State bank were turned over to the treasurer of the state of North Dakota (see *Green* v. *Frazier,* 253 U. S. 233, 235); yet the bank was held subject to the Federal capital stock tax. *State of North Dakota* v. *Olson* (C. C. A. 8th), 33 F. (2d) 848, dismissed for lack of jurisdiction, 280 U. S. 528. See also *School Dis-*

trict of Ft. Smith v. *Howe*, 62 Ark. 481, 485–486; *Cincinnati* v. *Lewis, Auditor*, 66 Oh. St. 49.

The tax in question must be sustained unless its effect is to cast a substantial burden on the State's operation of its schools. It is no more burdensome than that approved in *Metcalf & Eddy* v. *Mitchell, supra.* The State's efficiency in performing its governmental functions is not impaired. *Metcalf case, supra*, pp. 524–525. See *Thomas* v. *Gay*, 169 U. S. 264, 273; *Wagoner* v. *Evans*, 170 U. S. 588, 591; *Willcuts* v. *Bunn, supra*, pp. 230–231.

The Court of Appeals thought it was controlled by the decisions of this Court in *Gillespie* v. *Oklahoma*, 257 U. S. 501, and *Jaybird Mining Company* v. *Weir*, 271 U. S. 609. We think that the Court of Appeals gave insufficient weight to the many cases mentioned above in its endeavor to fit the present case into what it conceived to be the rule of the *Gillespie* case. That case must rest upon the unique relationship of the United States to its Indian wards, and the purpose of Congress to provide for their welfare by setting apart by allotment or otherwise tribal lands or the public domain restricted for their benefit. Such considerations as these, peculiar to restricted, allotted, or tribal lands of the Indians, led to the conclusion that neither leases of such lands nor their exploitation by the lessee, nor his income therefrom, may be taxed by the State. (*Shaw* v. *Oil Corporation*, 276 U. S. 575.) But these exemptions, thus extended to lessees of tribal and allotted Indian lands, can not

be extended to the lessees of other Government lands (*Forbes* v. *Gracey*, 4 Otto, 762), and if, as this Court has held in the *Gracey case*, the value of the gross product of a mining claim on Government lands can be subjected to State taxation, certainly the income derived by a lessee of State lands from the sale of such products may be subjected to Federal taxation. The effect of the *Gillespie case*, we submit, is not to impair the doctrine of the many cases in which this Court has held that profits arising from dealings with the State are not exempt from the general tax upon all income.

CONCLUSION

The question involves the constitutional power of the Federal Government to tax income derived by lessees of State lands, and is of equal importance in its effect upon the power of the State to tax such income derived from Government lands. We respectfully submit that the petition should be granted.

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AUGUST, 1931.

APPENDIX

Revenue Act of 1916, c. 463, 39 Stat. 756:

SEC. 10. That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized but not including partnerships, a tax * * *.

SEC. 11. (b) There shall not be taxed under this title any income derived * * * from the exercise of any essential governmental function accruing to any State * * *.

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1065, 1077:

SEC. 233. (a) That in the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in section 213, * * *.

SEC. 213. That for the purposes of this title * * * the term "gross income"—

(a) Includes gains, profits, and income derived * * * from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

Act of June 16, 1906, c. 3335, 34 Stat. 267, 270, 272, 273:

SEC. 3. Fifth. That provisions shall be made for the establishment and maintenance of a system of public schools, which shall be open to all the children of said State and free from sectarian control; * * *.

SEC. 7. That upon the admission of the State into the Union sections numbered sixteen and thirty-six, in every township in Oklahoma Territory, and all indemnity lands heretofore selected in lieu thereof, are hereby granted to the State for the use and benefit of the common schools: * * *.

There is hereby appropriated, out of any money in the Treasury not otherwise appropriated, the sum of five million dollars for the use and benefit of the common schools of said State in lieu of sections sixteen and thirty-six, and other lands of the Indian Territory. * * *

SEC. 8. * * *

Where any part of the lands granted by this Act to the State of Oklahoma are valuable for minerals, which terms shall also include gas and oil, such lands shall not be sold by the said State prior to January first, nineteen hundred and fifteen; but the same may be leased for periods not exceeding five years by the State officers duly authorized for that purpose, such leasing to be made by public competition after not less than thirty days' advertisement in the manner to be prescribed by law, and all such leasing shall be done under sealed bids and awarded to the highest responsible bidder. The leasing shall require and the advertisement shall specify in each case a fixed royalty to be paid by the successful bidder, in addition to any bonus offered for the lease, and all pro-

ceeds from leases shall be covered into the fund to which they shall properly belong, and no transfer or assignment of any lease shall be valid or confer any right in the assignee without the consent of the proper State authorities in writing: * * *.

Constitution of Oklahoma, Article XI:

SECTION 1. *State Accepts All Grants.*—The State hereby accepts all grants of land and donations of money made by the United States under the provisions of the Enabling Act, and any other Acts of Congress, for the uses and purposes and upon the conditions, and under the limitations for which the same are granted or donated; and the faith of the State is hereby pledged to preserve such lands and moneys and all moneys derived from the sale of any of said lands as a sacred trust, and to keep the same for the uses and purposes for which they were granted or donated.

Oklahoma Compiled Statutes of 1921:

SEC. 9415. *Commissioners to segregate public land containing oil and gas.*—When any tract of the school or other public lands, granted to the State of Oklahoma under the act of congress known as the "Enabling Act" is known by the commissioners of the land office of the State to contain oil or gas, or where such lands are, by said commissioners, deemed valuable for oil and gas purposes, such commissioners shall enter of record in their office their finding, declaring that such oil or gas character exists, and further declaring that the oil and the gas deposits are segregated from the surface use and interest therein, and such segregation of such deposits shall conclusively withhold the

same from sale, lease, or other alienation, except as provided in this article.

SEC. 9417. *Lease of oil and gas interest.*—The oil and gas interest described in this article in such lands may be leased by the commissioners of the land office for oil and gas purposes to the same extent and in the same manner as a private owner of lands in fee could, in his own right, execute a grant thereto, subject, however, to the following limitations:

First. For a period not exceeding five years, with suitable provisions for preference right to release for a second term of five years at its expiration, at the maximum rate of rentals, royalties, and bonuses that may be obtained therefor, at the time of such renewal.

Second. Upon due advertisement and public notice of not less than thirty days, in such manner as the commissioners may, by rule, prescribe.

Third. Such leasing shall be done under public bids and awarded to the highest responsible bidder: Provided, that the commissioners of the land office shall have power to reject any and all bids.

SEC. 9423. *Disposition of funds from oil and gas lands.*—The proceeds derived in bonuses and royalties and from other inducements and considerations for the execution and operation of the oil and gas leases in this article provided, shall be carried in the several funds, for the use and benefit of which such lands were granted by the United States to the State of Oklahoma, and to the territory now comprising the area embraced within the said State, under the provisions of the enabling act, and any and all other acts of Congress, for the uses and purposes,

and upon the conditions, and under the limitations for which the same were granted; and the money resulting from such lease and from the operation thereof shall be handled, disposed of and used in like manner as the other moneys belonging to said several funds under the laws of this State.

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FILE COPY

No. 341

In the Supreme Court of the United States

October Term, 1931

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CORONADO OIL AND GAS COMPANY

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE DISTRICT OF COLUMBIA

BRIEF FOR THE PETITIONER

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In the Supreme Court of the United States

OCTOBER TERM, 1931

No. 341

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

CORONADO OIL AND GAS COMPANY

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE DISTRICT OF COLUMBIA

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 24–52) is reported in 14 B. T. A. 1214. The opinion of the Court of Appeals of the District of Columbia (R. 96–102) is reported in 50 F. (2d) 998.

JURISDICTION

The judgment of the Court of Appeals was entered June 1, 1931. (R. 102.) The petition for the writ of certiorari was filed September 1, 1931,

and was granted October 26, 1931. (R. 103.) The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the United States may constitutionally impose a tax upon the net income of a private corporation derived from the sales of oil and gas produced under lease to it of lands owned by the State of Oklahoma and set apart for the maintenance of its common schools.

STATUTES INVOLVED

The statutes involved are set forth in the appendix, pp. 32–36, *infra*.

STATEMENT

By the Oklahoma Enabling Act Congress required, as a condition of admission into the Union, that the State should make provision in its constitution for a system of common schools, and for this purpose granted to the State certain lands, with the proviso that such as were valuable for minerals should not be sold but might be leased for periods of five years, the proceeds to be paid to the school fund. (R. 26.) Act of June 16, 1906, Sections 3, 7 and 8, c. 3335, 34 Stat. 267, 270, 272, 273, p. 33, *infra*. The State, by its constitution, provided for a common-school system, and pledged its faith to preserve the lands and moneys derived

from them as a "sacred trust" for the purposes for which the lands were granted. Constitution of Oklahoma, Article XI, Section 1, p. 34, *infra*. Legislative provision was made for leasing the lands containing gas and oil, and for the payment of the proceeds into the school fund. Oklahoma Compiled Statutes 1921, Sections 9415, 9417 and 9423, pp. 34–36, *infra*.

The State leased certain of these lands to respondent, an Oklahoma corporation, in January, 1914 (R. 27), renewing the lease (on somewhat different terms) in March, 1919 (R. 34, 59–95). Respondent agreed to deliver to the State under the first lease 50 per cent, and under the second lease 12½ per cent, of the gross production of oil and gas. (R. 30, 35.)

The Commissioner of Internal Revenue assessed taxes upon respondent's net income derived through the sale of its share of the oil and gas obtained from the leased lands during 1917, 1918, and 1919. (R. 25.) The Board of Tax Appeals sustained the action of the Commissioner. (R. 50; 14 B. T. A. 1214.) The Court of Appeals of the District of Columbia (Martin, C. J., dissenting) reversed the decision of the Board. (R. 96–102.)

SPECIFICATION OF ERROR

The Court of Appeals erred in holding that the United States was without power to tax the respondent's net income derived from the sale of the

respondent's share of oil and gas produced under lease of lands owned by the State of Oklahoma and set apart for the maintenance of its common schools.

SUMMARY OF ARGUMENT

1. The effect of the Federal tax, in the circumstances of this case, is too indirect and remote to interfere with any governmental function of the State. The tax involved is less direct and burdensome than the tax which this Court sustained in *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, or the tax sustained in *Willcuts* v. *Bunn*, 282 U. S. 216. The decision below is contrary to the principle of *Forbes* v. *Gracey*, 94 U. S. 762; *Gromer* v. *Standard Dredging Co.*, 224 U. S. 362; *Baltimore Shipbuilding Co.* v. *Baltimore*, 195 U. S. 375, and the cases following them. It is likewise contrary to the principle of the decisions of this Court in *United States Glue Co.* v. *Oak Creek*, 247 U. S. 321, *Shaffer* v. *Carter*, 252 U. S. 37; *Underwood Typewriter Co.* v. *Chamberlain*, 254 U. S. 113.

2. The respondent is a private corporation engaged in business for its own profit. If for any purpose the respondent is an agency of the State, it is not exempt from the tax imposed upon income derived from the exercise of nongovernmental functions.

3. The decision of this Court in *Gillespie* v. *Oklahoma*, 257 U. S. 501, is not controlling here. That

decision rests on the peculiar relation of the United States to its Indian wards, and is in agreement with a recognized federal policy that any activity of the Federal Government in behalf of the Indians shall not be affected even very remotely by state taxation. Further, the decision is inapplicable here because the question as to whether there the lessee was a federal instrumentality was not argued or decided. It is also distinguishable because it dealt with the absolute immunity of activities and instrumentalities of the United States from State taxation, whereas the States enjoy no such immunity *unless* their activities are strictly governmental. *South Carolina* v. *United States,* 199 U. S. 437.

ARGUMENT

I

THE EFFECT OF THE FEDERAL INCOME TAX IN THE CIRCUMSTANCES OF THIS CASE IS TOO INDIRECT TO INTERFERE WITH ANY GOVERNMENTAL FUNCTION OF THE STATE

The effect of a tax upon the net income of respondent's business is too indirect and too remote to constitute an interference with any governmental function of the State. The tax is not laid upon the State. It is laid upon the respondent, a private corporation organized for private profit. See *Clallam County* v. *United States,* 263 U. S. 341, 345. The tax is not laid upon the petitioner's operations or its gross receipts from gas and oil

produced, nor is it laid upon the making of the lease; it is laid upon respondent's net income derived from all its business. The tax is not discriminatory; it is laid upon the net income of all corporations similarly situated throughout the United States. We believe that the decisions of this Court establish that such a tax is not an unconstitutional interference with the functions of a State.

It was pointed out by this Court in *Willcuts* v. *Bunn*, 282 U. S. 216, 231, that—

> It must be remembered that we are dealing, not with any express constitutional restriction, but only with an asserted implication.

The "asserted implication" has been re-examined in this Court in every new situation. In so far as taxes not directly laid upon a State or its instrumentalities are concerned, the limitation implied from the Constitution is not absolute, and must receive a practical construction which permits both the national government and the state governments to exercise their individual functions without serious impairment or interference. See *South Carolina* v. *United States*, 199 U. S. 437, 451–452. To extend the implied limitation too far is to defeat its very purpose by imposing unnecessary restrictions upon the essential sovereign power of taxation possessed by both the state and national governments. Distinctions, therefore, must be carefully drawn and their validity must be judged by their

practical effect.[1] In *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, it was said (pp. 523–524):

> * * * the limitation upon the taxing power of each, so far as it affects the other, must receive a practical construction which permits both to function with the minimum of interference each with the other; * * *.

Our thesis was stated by this Court in *Railroad Co.* v. *Peniston*, 18 Wall. 5:

> It may, therefore, be considered as settled that no constitutional implications prohibit a State tax upon the property of an agent of the government merely because it is the property of such an agent (p. 33).
>
> It is, therefore, manifest that exemption of Federal agencies from State taxation is dependent, not upon the nature of the agents, or upon the mode of their constitution, or upon the fact that they are agents, but upon the effect of the tax; that is, upon the question whether the tax does in truth deprive them of power to serve the government as they were intended to serve it, or does hinder the efficient exercise of their power (p. 36).

The practical operation and effect of a tax has been constantly in the mind of this Court. In

[1] See *Powell*, "Indirect Encroachment on Federal Authority By the Taxing Powers of the States," 31 Harv. L. Rev. 321, 324, 327; 32 Harv. L. Rev. 902, 918, 926; *Cohen and Dayton*, "Federal Taxation of State Activities and State Taxation of Federal Activities," 34 Yale L. J. 807, 818, 821, 827; *Note*, 28 Ill. L. Rev. 707, 711; *Note*, 30 Col. L. Rev. 92, 103.

Plummer v. *Coler,* 178 U. S. 115, it was said (p. 136):

> * * * we still may be permitted to perceive that the mischief to our national credit, so feelingly deplored in the briefs, * * * would be inappreciable, and too remote and uncertain to justify us now in condemning the tax system of the State of New York.

Compare *St. Louis Southwestern Ry. Co.* v. *Arkansas,* 235 U. S. 350, 362; *Mountain Timber Co.* v. *Washington,* 243 U. S. 219, 237; *Crew Levick Co.* v. *Pennsylvania,* 245 U. S. 292, 294; *American Mfg. Co.* v. *St. Louis,* 250 U. S. 459, 463; *Shaffer* v. *Carter,* 252 U. S. 37, 55.

In *Heiner* v. *Colonial Trust Co.,* 275 U. S. 232, a tax was sustained which might have "some perceptible economic effect on the Indians." (P. 235.) In *Willcuts* v. *Bunn, supra,* this Court said (p. 230):

> No facts as to actual consequences are brought to our attention * * * showing that the inclusion in the federal tax of profits on sales of state and municipal bonds casts any appreciable burden on the States' borrowing power.

and at p. 231:

> * * * it must clearly appear that a substantial burden upon the borrowing power of the State would actually be imposed.

See also *Flint* v. *Stone Tracy Co.,* 220 U. S. 107, 162. The test of the directness of the effect of a

tax was also applied by this Court in *Thomas* v. *Gay*, 169 U. S. 264, 273, and *Wagoner* v. *Evans*, 170 U. S. 588, 591.

It is possible that future lessees of lands like those here may bid more for a lease if they can escape the burden of the income tax which rests upon competitors deriving materials from lands leased from private individuals, but we submit that such effect would not directly or substantially burden the State in maintaining its school system. As was said in *Group No. 1 Oil Corp.* v. *Bass*, 283 U. S. 279, a case like the instant case, except that decision there turned upon Texas decisions holding the lease in question was a sale of oil and gas in place—

> Property sold *or otherwise disposed of* by the government, either state or national, in order to raise revenue for government purposes, is in a broad sense a government instrumentality, with respect to which neither the property itself before sale, nor its sale by one government, may be taxed by the other. But it does not follow that the same property in the hands of the buyer, or his use or enjoyment of it, or the income he derives from it, is also tax immune. *New Brunswick* v. *United States*, 276 U. S. 547; *Forbes* v. *Gracey*, 94 U. S. 762; *Tucker* v. *Ferguson*, 22 Wall. 527; see *Weston* v. *Charleston*, 2 Pet. 449, 468; *Veazie Bank* v. *Fenno*, 8 Wall. 533, 547. Theoretically, any tax imposed on the buyer with respect to the purchased property may have some ef-

> fect on the price, and thus remotely and indirectly affect the selling government. We may assume that if the property is subject to tax after sale, the governmental seller will generally receive a less favorable price than if it were known in advance that the property in the hands of later owners, or even of the buyer alone, could not be taxed.
>
> But the remote and indirect effects upon the one government of such a nondiscriminatory tax by the other have never been considered adequate grounds for thus aiding the one at the expense of the taxing power of the other. See *Willcuts* v. *Bunn,* 282 U. S. 216, 231; *Educational Films Corp.* v. *Ward,* 282 U. S. 379; *Metcalf & Eddy* v. *Mitchell,* 269 U. S. 514, 523–524. * * * (P. 282.) (Italics ours.)

Yet the ultimate economic effect of the tax in the *Group No. 1* case is, of course, precisely the same as in the instant case.

The tax involved in this case is less direct and burdensome than the tax which this Court sustained in *Metcalf & Eddy* v. *Mitchell, supra.* Metcalf and Eddy made contracts with States and subdivisions of States, under which they performed engineering services in connection with sanitary projects, for which they were paid from public funds. Like the respondent in the present case they contended that they were an instrumentality of the State, but this Court held otherwise, and said (pp. 522–523, 524–525):

> * * * it is apparent that not every person who uses his property or derives a profit, in his dealings with the government, may clothe himself with immunity from taxation on the theory that either he or his property is an instrumentality of government * * *.
>
> * * * * *
>
> The tax is imposed without discrimination upon income whether derived from services rendered to the state or services rendered to private individuals. In such a situation it can not be said that the tax is imposed upon an agency of government in any technical sense, and the tax itself can not be deemed to be an interference with government, or an impairment of the efficiency of its agencies in any substantial way.

The same result was reached in *Lucas* v. *Howard,* 280 U. S. 526, and *Lucas* v. *Reed,* 281 U. S. 699; yet in each of these cases the income taxed was received directly from the State, while in the present case the income taxed is derived from private business transactions with third persons.

If Metcalf and Eddy had been employed to manage the production and sale of the oil on these lands for the State of Oklahoma, compensation received for such services would under the decision in their case certainly have been taxable income. The *Metcalf & Eddy* case can not be distinguished upon the theory that the lessee here is a governmental agency in the performance of governmental functions. It can not be said that construction and maintenance by States of municipal water

and sewerage works are less governmental than oil and gas development by private corporations.

The principle applicable to the present case is that of *Forbes* v. *Gracey*, 94 U. S. 762. There this Court sustained a tax levied by a State upon ore extracted from mining lands. The taxpayer held a mining claim from the United States, but title to the lands on which the mines were situated was in the United States. The decision was that ore severed from the mine became personal property and that the rights of the United States were not affected either by tax on the ore itself or by a provision of the taxing law whereby the tax became a lien on mining claims. It was pointed out that mining claims were property which could be sold, transferred, mortgaged, and inherited without infringing the title of the United States, and that the United States would not be at all affected by the sale of the mining claim to enforce the tax lien. The analogy is obvious. In the present case the oil and gas from the sale of which income is derived is the personal property of the lessee once it has been produced and the State can have no interest in the lessee's profit derived from its sale. And to the argument that the State has an interest in developing oil and gas lands, the answer is that the interest of the United States in developing the mining lands in the Western States is quite as important as the interest of the State of Oklahoma in the present case. If, therefore, the State may tax the product of land, title to which is in the Federal Govern-

ment, *a fortiori* the Federal Government may tax net income realized from the sale of the product of land to which the State has title.

The cases are numerous where private gains more immediately connected with the business of Government have been held by this Court to be within reach of the taxing power. In *Gromer* v. *Standard Dredging Co.*, 224 U. S. 362, this Court held that Porto Rico might tax machinery and boats engaged in dredging work in San Juan Harbor in pursuance of a contract with the United States. In *Baltimore Shipbuilding Co.* v. *Baltimore*, 195 U. S. 375, it was held that a State might tax the interest of a company owning a dry dock in land conveyed to it by the United States, notwithstanding provisions in the instrument of conveyance that upon certain contingencies the property should revert to the United States and that the United States had a continuing interest to use the dry dock to serve its purposes.

In *South Carolina* v. *United States, supra*, it was held that the Federal Government might exact a license tax from State agencies operating liquor dispensaries established by the State of South Carolina.

In *Alward* v. *Johnson*, 282 U. S. 509, it was held that a State might levy a gross receipts tax upon the franchises and property of a bus line, although three-fourths of its revenues were earned by carrying the United States mail. In *Elder* v. *Wood*, 208

U. S. 226, it was held that a State might tax a mining claim held under the United States, although title to the land remained in the United States. In *New Brunswick et al.* v. *United States,* 276 U. S. 547, it was held that land, title to which was in the United States Housing Corporation, might be taxed by the city to persons under agreement to purchase such land.

In *Shaw* v. *Oil Corporation,* 276 U. S. 575, it was held that the State of Oklahoma might impose a tax on the gross value of oil and gas produced under a lease of lands which were purchased for a full-blood Creek Indian, by his guardian, with royalties received from a lease of his restricted lands. The lands in question were inalienable by him without the consent of the Secretary of the Interior. In *Choctaw, O. & G. Railroad Company* v. *Mackey,* 256 U. S. 531, it was held that an Oklahoma municipality might levy a special assessment for street improvements against part of the right of way and station ground of a lessee railroad company whose lessor was a corporation to which Congress had granted the right to build a railroad in Indian Territory, with a branch line to coal mines leased from the Choctaw Nation. In *Thomas* v. *Gay, supra,* it was held that an Oklahoma county might tax cattle grazing on Indian lands under certain leases for grazing purposes made by the Osage tribal government as lessor, subject to the ratification of the Commissioner of Indian Affairs and of the Secretary of the Interior.

In *Thomson* v. *Pacific Railroad Co.*, 9 Wall. 579, it was held that a State might tax property of a railroad corporation which had been the recipient of benefits by way of subsidy from the United States, and which was bound to perform certain services for the United States. In *Railroad Company* v. *Peniston, supra,* it was held that Lincoln County, Nebraska, could tax the Union Pacific Railroad Company on its property in the county, although the railroad company was a Federal corporation chartered for the purposes, among others, of carrying the mails, of transporting troops and supplies, and of performing other services for the United States. See also *Central Pacific Railroad Company* v. *California,* 162 U. S. 91.

In *Willcuts* v. *Bunn, supra,* it was decided that the United States could impose a tax upon a profit derived from a sale by a private owner of municipal and state bonds. In that case this Court said:

> The sale of the bonds by their owners, after they have been issued by the State or municipality, is a transaction distinct from the contracts made by the government in the bonds themselves, and the profits on such sales are in a different category of income from that of the interest payable on the bonds (p. 227).

Similarly, we submit that the sale of the oil and gas by the respondent to third persons was a transaction distinct from the lease made between the respondent and the State, and that the profits from

such sales are not in the same category of income as the rental paid by the respondent to the State.

See also *Educational Films Corp.* v. *Ward,* 282 U. S. 379, in which this Court held that a state tax imposed upon the privilege of doing business was not sufficiently burdensome on an instrumentality of the Federal Government to be invalid, even though the measure of the tax included the income from copyrights.

It should be borne in mind, in determining whether the present tax is a burden upon the State, that the tax is imposed upon net income and not upon gross receipts. This Court has frequently pointed out that a tax on net income does not constitute a direct burden upon the subject from which the income is derived. Thus, in *Peck & Co.* v. *Lowe,* 247 U. S. 165, and in *Barclay & Co.* v. *Edwards,* 267 U. S. 442, it was held that a net income tax may constitutionally be imposed upon the income derived from the business of exporting goods from the United States, although Clause 5 of Section 9 of Article I of the Constitution provides that "No Tax or Duty shall be laid on Articles exported from any State." And it has several times been held that a State may validly lay a net income tax upon income derived from interstate commerce. *United States Glue Co.* v. *Oak Creek,* 247 U. S. 321; *Shaffer* v. *Carter,* 252 U. S. 37; *Underwood Typewriter Co.* v. *Chamberlain,* 254 U. S. 113.

The principle involved in the *Metcalf & Eddy* case has been applied by this Court and other courts

in other situations. Thus, in *Veazie Bank* v. *Fenno*, 8 Wall. 533, this Court upheld a tax on notes issued by a bank operating under a state franchise. In *National Bank* v. *United States*, 101 U. S. 1, a tax on notes issued by a municipality and used as money was upheld. In *Manhattan Co.* v. *Blake*, 148 U. S. 412, it was held that a Federal tax on the average deposits of a bank was not unconstitutional by reason of the fact that there were included moneys deposited by the treasurer of the State of New York. In *Snyder* v. *Bettman*, 190 U. S. 249, a succession tax on the transfer of property by will to a municipality was upheld. And in *James A. Sackley Co.* v. *United States*, 65 C. Cls. 304, it was held that the Federal income tax might be imposed upon income derived from a contract to pave the streets of a municipality.

See also *Henderson Bridge Co.* v. *Henderson City*, 173 U. S. 592 (tax on interstate bridge erected by consent of Congress); *Thompson* v. *Kentucky*, 209 U. S. 340 (tax on whiskey in government warehouse); *Wagoner* v. *Evans*, *supra* (tax on cattle grazing on leased Indian lands); *Montana Catholic Missions* v. *Missoula County*, 200 U. S. 118 (tax on cattle customarily destined for Indian charities); *United States* v. *Ransom*, 263 U. S. 691 (tax on land bought for an Indian with oil-lease royalties); *Swarts* v. *Hammer*, 194 U. S. 441 (tax on property held by a trustee under Federal Bankruptcy Act).

II

IF FOR ANY PURPOSE THE RESPONDENT IS AN AGENCY OF THE STATE IT IS NOT EXEMPT FROM THE TAX IMPOSED UPON INCOME DERIVED FROM THE EXERCISE OF NON-GOVERNMENTAL FUNCTIONS

As lessee of state lands the respondent is engaged in producing oil and gas for the State and for itself. In so far as its share of the product is concerned, it is engaged, like any other producer, in conducting a business enterprise for private profit.[2]

In upholding the immunity from state taxation of a corporation created and exclusively employed as an instrumentality of the United States, this Court, in *Clallam County* v. *United States*, *supra*, said (p. 345):

> This is not like the case of a corporation having its own purposes as well as those of the United States and interested in profit on its own account.

The fact that the State of Oklahoma is entitled to a share of the product as a royalty under the lease does not convert the respondent's business of selling its own share of the product for profit into the performance of a governmental function. No doubt the mutual advantages of production are the considerations for the lease, and the relationship between the respondent and the State is substan-

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[2] See *Cohen and Dayton*, "Federal Taxation of State Activities and State Taxation of Federal Activities," 34 Yale Law Journal, 807, 821; *Note*, 23 Illinois Law Review, 707, 711.

tially contractual. But such relationships do not convert private concerns into governmental agencies and exempt them from the burden of general taxation. This Court in *Fidelity & Deposit Co.* v. *Pennsylvania*, 240 U. S. 319, said (p. 323):

> But mere contracts between private corporations and the United States do not necessarily render the former essential governmental agencies and confer freedom from state control. *Baltimore Shipbuilding Co.* v. *Baltimore*, 195 U. S. 375.

See also *Hall* v. *Wisconsin*, 103 U. S. 5, 10; *Baltimore Shipbuilding Co.* v. *Baltimore*, *supra*, 382; and *Metcalf & Eddy* v. *Mitchell*, *supra*, at pp. 524–525.

Another consideration was raised in *Montana Catholic Missions* v. *Missoula County*, 200 U. S. 118, where this Court said (p. 130):

> Congress has not constituted this corporation an agency of its own for the purpose of discharging any duties which the Government may owe to the Indians.

In *South Carolina* v. *United States*, 199 U. S. 437, it was held that an agent of the State of South Carolina, carrying on the business of selling liquor under state authority, was liable to pay the internal revenue tax imposed by the Federal Government. The rule in that case is that the exemption of state agencies and instrumentalities is limited to those of strictly governmental character, and does not extend to those used by the State in carrying on

business of a private character. (*Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 157.)

We submit that the respondent's business of selling its share of oil and gas produced is less governmental in character than the business involved in the *South Carolina* case of dispensing liquor.

In *Salt Lake City* v. *Hollister*, 118 U. S. 256, it was held that a city engaged in the business of distilling spirits was subject to the internal revenue laws of the United States, although the profits were paid into the city treasury. The economic effect of the tax sustained by this Court in *City of Philadelphia* v. *The Collector*, 5 Wall. 720, was imposed upon a gas plant which was in substance owned and in fact operated by the city of Philadelphia. See also *United States Bank* v. *Planters' Bank*, 9 Wheat. 904; *State of North Dakota* v. *Olson*, 33 F. (2d) 848 (C. C. A. 8th), dismissed for lack of jurisdiction, 280 U. S. 528; *School District of Fort Smith* v. *Howe*, 62 Ark. 481.

If the State itself were to enter the business of producing and selling oil and gas its agent could be taxed under the doctrine of the *South Carolina* case, the *Hollister* case and the *Olson* case. It would be liable for its torts in connection with that business because the production of oil and gas is not a governmental function. See *Salt Lake City* v. *Hollister*, *supra*, 261; *City of Philadelphia* v. *Gavagnin*, 62 Fed. 617 (C. C. A. 3d); *Duggan* v. *Peabody*, 187 Mass. 349; *Oliver* v. *Worcester*, 102

Mass. 489; *Hoppe* v. *City of Winona*, 113 Minn. 252.

It is difficult to see why the income of a private corporation should be exempt from taxation because it is the lessee of the state government when a tax laid on the same activity of the state government would be valid. We submit that the use made of the funds, which chances to have been designated by the Enabling Act, does not override the doctrine which would be applicable if the State itself had gone into the oil business.

III

GILLESPIE v. OKLAHOMA, 257 U. S. 501, IS NOT CONTROLLING

In the opinion of the court below, after reviewing the decisions of this Court cited in support of the contention that the tax is not imposed upon the lands or upon the oil or gas or the proceeds of the same, which the State is entitled to receive, but is confined solely to that portion of the value of the gas and oil produced which appellant as a private corporation is entitled to have and use for its own account, and that therefore the tax does not interfere with or impose a burden upon the State, the court said:

> * * * there is much strength and force in this argument, and, if the question were not, as we think, foreclosed, we are inclined to think we might feel impelled to adopt the view; but, as we see it, the Supreme Court has laid down the rule in *Gillespie* v. *Okla-*

homa, 257 U. S. 501, and *Jaybird Mining Co.* v. *Weir,* 271 U. S. 609, by which we are controlled.

It must at once be conceded that if the decision in the *Gillespie case* is extended in its application to facts differing only slightly, but still differing, from the facts involved in that case, the court below had much reason for believing its decision to be controlled by the decision of this Court in the *Gillespie case.* That decision was, however, predicated upon the peculiar and anomalous relationship existing between the United States and its Indian wards, and particularly upon the duties and obligations of the Federal Government as trustee for the Indians of restricted Indian lands. The anomalous character of these relationships and duties was emphasized by this Court in *Shaw* v. *Oil Corporation,* 276 U. S. 575, where lands purchased for an Indian were held to be subject to state taxation. There it was said (p. 578):

> What governmental instrumentalities will be held free from state taxation, though Congress has not expressly so provided, cannot be determined apart from the purpose and character of the legislation creating them. *Metcalf & Eddy* v. *Mitchell,* 269 U. S. 514. The end sought and the mode of attaining it adopted by Congress in the legislation providing for the welfare of the Indians by setting apart, by allotment or otherwise, tribal lands or the public domain, restricted for their benefit, led to the conclusion that those

> lands and the uses of them were so intimately connected with the performance of governmental functions as clearly to require independence of all state control so complete that nothing short of an express declaration by Congress would have subjected them to state taxation.

Gillespie v. *Oklahoma, supra,* pushed this exemption to the limit by exempting from state taxation upon incomes generally income derived by a lessee of unrestricted Indian lands from the sale of oil and gas produced under the lease. This was a step beyond the later decision of this Court in *Jaybird Mining Co.* v. *Weir,* 271 U. S. 609, where the tax sustained was imposed upon ores in mass at the mine before sale. This was a step beyond the prior decisions of this Court in *Choctaw, Oklahoma & Gulf R. R. Co.* v. *Harrison,* 235 U. S. 292; *Indian Territory Illuminating Oil Co.* v. *Oklahoma,* 240 U. S. 522; *Howard* v. *Gypsy Oil Co.,* 247 U. S. 503, and *Large Oil Co.* v. *Howard,* 248 U. S. 549, where it was held that lessees of restricted Indian lands could not be subjected to state taxation based upon gross production from the leased lands. In *Jaybird Mining Co.* v. *Weir, supra,* this Court was not required to go beyond the principle of the decisions which antedated the decision in the *Gillespie case,* for there the tax involved was assessed on the ores in mass at the mine before sale, and was not a tax imposed generally upon all income.

For the first time, this Court is now asked to extend the decision in the *Gillespie case* so as to exempt from the Federal income tax the income derived by a lessee of state lands from the sale of its share of oil and gas produced under the lease.

If the principle underlying the decision in the *Gillespie case* were one of general and universal application, to be extended to all instrumentalities of government regardless of the purposes of their creation or the functions for the performance of which they are created, the simple statement that the *Gillespie case* is controlling might well be accepted without further thought. But this field of the law, as the decisions disclose, from the time of *McCulloch* v. *Maryland,* 4 Wheat. 316, to the present day, is one in which the rules are not absolute, and in the delicate balance of conflicting limitations upon governmental powers arising only by implication each case must be determined by the very considerations referred to by this Court in *Shaw* v. *Oil Corporation, supra,* namely, the purpose and character of the legislation creating the instrumentality of government, and, it goes without saying, the particular governmental functions which it is created to perform.

The differences in purpose and function of the lease in this case and the lease in the *Gillespie case* are plainly to be found in the peculiar and anomalous character of lands originally granted to the Indian Tribes as independent nations, and in the duties which the Federal Government has assumed

toward these peoples, not only as wards of the Nation but as the beneficiaries of such lands held in trust for them by the Nation. That the decisions of this Court dealing with such lands have been influenced by such considerations is entirely clear, and is emphasized by the quotation from the opinion of this Court in *Shaw* v. *Oil Corporation, supra.* That such considerations influenced the decision of this Court in the *Gillespie case* is emphasized by the fact that that decision stands alone within this field of the law, and, if such considerations be ignored, is in apparent conflict with numerous decisions which we have cited under Point I, *supra.*[3]

As Marshall, C. J., said in *Cherokee Nation* v. *State of Georgia,* 5 Pet. 1, 16, "The condition of the Indians in relation to the United States is, perhaps, unlike that of any other two people in existence."

The relationship between the United States and its Indian wards involved in the *Gillespie case,* and other cases dealing with Indian lands, presented

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[3] It is generally recognized that the Indian cases stand by themselves as the expression of a policy. In a note in 23 Illinois Law Review, 707, referring to the Indian cases, the writer says (p. 712):

"The results reached in several of these cases are quite out of line with prior decisions of the Court, and must be explained as due to anxiety to protect to the fullest possible extent the development of Indian properties for the benefit of these wards of the Nation. It is unsafe to use such decisions as establishing principles of general application."

A note in 30 Columbia Law Review, 92, referring to the decision in the *Kansas Indians,* 5 Wall. 737, which holds that

a unique situation because of the dependence of the Indians on the Federal Government and the promises of the latter to protect their property. The obligations to these tribes were assumed pursuant to constitutional authority, and the Federal Government became obligated to secure the greatest possible benefit from the mineral-bearing lands which it held and administered in trust for them. This it undertook to do by leasing these lands, and in making such leases it was directly engaged in the performance of a sovereign duty which it had expressly assumed under authority of the Constitution. See *Choctaw Gulf R. R.* v. *Harrison, supra,* p. 298, and *Indian Oil Co.* v. *Oklahoma, supra,* p. 530. And thus it was held that to tax the lands at all was "to tax an instrumentality employed by the United States for the benefit and control of this dependent race." *United States.* v. *Rickert,* 188 U. S. 432.

And so we believe that we are justified in contending that the court below fell into error in con-

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a State property tax could not be levied on Indian lands, says (note 16, p. 93):

"It must be noted, however, that the anomalous position which the Indians occupy in our law weakens the probative value of such decisions in other situations involving federal instrumentalities."

A note in 42 Harvard Law Review, 128, refers to the *Jaybird* case in this language:

"This class of cases is distinguishable, however, as resulting from a strong governmental policy of protecting Indians in their lease allotments, rather than a genuine attempt to protect a federal instrumentality." (Citing *Shaw* v. *Gibson-Zahniser Oil Corporation, supra.*)

cluding that its decision was controlled by the decision of this Court in the *Gillespie case*, because of the essential differences in the governmental functions involved in this case. It should also be noted that in the *Gillespie case* the State conceded that the lessee was a governmental agency of the United States.[4] It was said in that case (p. 504):

> It is agreed that the lessee was an instrumentality used by the United States in carrying out duties to the Indians that it had assumed, and that the only question in the case is whether he is liable to this kind of tax.

No such concession is made by the Government in this case. Indeed, we cannot see any difference in substance between the lessee in this case and the lessee in the *Group No. 1 Oil Case, supra*, and

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[4] From an examination of the record in that case it appears that the respondent State made no argument as to the capacity in which the lessee received his net income. The appellant lessee presented as the first point in his brief in this Court that he was an instrumentality of the Federal Government (*Gillespie*, Pet. Br. 27–31) under the rule in *Choctaw, etc., R. Co.* v. *Harrison*, 235 U. S. 292, 298; *Indian Oil Co.* v. *Oklahoma*, 240 U. S. 522, 529; *Howard* v. *Gypsy Oil Co.*, 247 U. S. 504 (per curiam); *Large Oil Co.* v. *Howard*, 248 U. S. 549 (per curiam); *Large Oil Co.* v. *Howard*, 63 Okla. 143; *Re Tax of Wolverine Oil Co.*, 53 Okla. 24. The brief of the respondent State did not present any discussion of this phase of the case, unless that is implicit in its statement (Resp. Br. 4) that the sole question was whether the tax was "an unlawful burden upon a federal agency or instrumentality."

Further, in the first opinion of the Supreme Court of Oklahoma (delivered December 14, 1920, and abandoned entirely

we venture to urge that the delicate balance of implied limitations upon the exercise of governmental power should not be disturbed by distinctions drawn between the legal conception of a lease which is a sale of oil and gas in place and a lease under which the traditional relationship between landlord and tenant exists. The agreement of counsel in the *Gillespie case* that the lessee was an instrumentality of the Federal Government apparently made it unnecessary for this Court to consider the activities of the lessee in order to determine whether, in selling its share of the oil produced and endeavoring to derive a profit therefrom, it was in

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by the decision of April 5, 1921, 81 Okla. 103, which was the decison this Court reviewed), it is said (*Gillespie*, R. 69–70):

"* * * The parties agree that the Attorney General correctly states the question of law at issue in his brief, as follows:

"The only question presented other than the one of penalties is whether or not the state is prevented from collecting income tax from leases on Indian lands under the supervision and approval of the Secretary of the Interior upon the same considerations which led the Court to deny that right to the State in what is known as the gross production tax cases, to-wit: *Choctaw & Gulf R. R. Co.* v. *Harrison*, 235 U. S. 292, * * *; *Indian Oil Co.* v. *Oklahoma*, 240 U. S. 522 * * *; *Howard* v. *Gypsy Oil Co.*, 247 U. S. 504 * * *; *Large Oil Co.* v. *Howard*, 248 U. S. 549 * * *.

"As it is agreed between counsel that under the cases just cited it is settled law [that leases are under federal protection and] that the lessees are Federal Agencies in whose hands the leases can not be taxed either directly or vicariously, it will not be necessary to notice any of the aspects of the case at bar except those which the Attorney General contends distinguish it from the cases cited."

fact performing a governmental function in the exercise of a governmental agency. Here, we contend that in selling its own share of the product from the leased land the respondent was engaged in the performance of no governmental function, and was not exercising any agency of the State.

There is a further distinction which may possibly be drawn between the activities of the United States and those of the States. Because of the fundamental supremacy of the Constitution, law, and treaties of the United States, constitutional powers delegated to persons or corporations by the Federal Government are necessarily beyond the reach of any power of the States, including the power of taxation. *California v. Pacific R. R. Co.*, 127 U. S. 1, 41. Thus, it was said in the *Jaybird case, supra* (p. 613): "The federal government in all its activities is independent of state control." And in the *Gillespie case, supra*, the decision of this Court was grounded upon the absolute immunity from taxation of all instrumentalities of the United States, it being said in the opinion (p. 505): "The rule as to instrumentalities of the United States * * * is absolute in form * * *." The activities of a State, however, enjoy no such absolute immunity from Federal taxation, the validity of such taxation, as we have seen, being dependent upon the nature of the activities in which the State, through its agencies, may be engaged. If these

activities are not of a strictly governmental character, they may be subjected to Federal taxation. *South Carolina* v. *United States, supra; Flint* v. *Stone Tracing Co., supra* (p. 157); cf. *McCulloch* v. *Maryland, supra.* See also *United States Bank* v. *Planters' Bank*, 9 Wheaton, 904, 907; *Hall* v. *Wisconsin, supra* (p. 11); *Van Brocklin* v. *State of Tennessee*, 117 U. S. 151 (p. 158); *State of Alabama* v. *United States* (Ct. Cls.), 38 F. (2d) 897, 902; dismissed for want of jurisdiction, 282 U. S. 502.

In this case we submit that the sale of oil and gas from which income was derived by the lessee was not an activity of a strictly governmental character, and if such business had been conducted directly, through agencies of the State, it would nevertheless have been subject to Federal taxation under the decision of this Court in the *South Carolina case, supra.* This was strictly private business, conducted by a private corporation for its own profit. To tax such profits does not impose a burden upon the strictly governmental functions of the State. Whenever a State engages in private business that business is not withdrawn from the taxing power of the nation. *South Carolina* v. *United States, supra,* p. 463.

CONCLUSION

The decision of the court below should be reversed.

Respectfully submitted.

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DECEMBER, 1931.

APPENDIX

Revenue Act of 1916, c. 463, 39 Stat. 756:

> SEC. 10. That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized but not including partnerships, a tax * * *.
>
> SEC. 11. (b) There shall not be taxed under this title any income derived * * * from the exercise of any essential governmental function accruing to any State * * *.

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1065, 1077:

> SEC. 233. (a) That in the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in section 213, * * *.
>
> SEC. 213. That for the purposes of this title * * * the term "gross income"—
>
> (a) Includes gains, profits, and income derived * * * from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for

gain or profit, or gains or profits and income derived from any source whatever. * * *

Act of June 16, 1906, c. 3335, 34 Stat. 267, 270, 272, 273:

SEC. 3. Fifth. That provisions shall be made for the establishment and maintenance of a system of public schools, which shall be open to all the children of said State and free from sectarian control; * * *.

SEC. 7. That upon the admission of the State into the Union sections numbered sixteen and thirty-six, in every township in Oklahoma Territory, and all indemnity lands heretofore selected in lieu thereof, are hereby granted to the State for the use and benefit of the common schools: * * *.

There is hereby appropriated, out of any money in the Treasury not otherwise appropriated, the sum of five million dollars for the use and benefit of the common schools of said State in lieu of sections sixteen and thirty-six, and other lands of the Indian Territory. * * *

SEC. 8. * * *

Where any part of the lands granted by this Act to the State of Oklahoma are valuable for minerals, which terms shall also include gas and oil, such lands shall not be sold by the said State prior to January first, nineteen hundred and fifteen; but the same may be leased for periods not exceeding five years by the State officers duly authorized for that purpose, such leasing to be made by public competition after not less than thirty days' advertisement in the manner to be prescribed by law; and all such leasing shall be done under sealed bids and awarded to the highest responsible bidder. The leasing shall require and the advertisement shall

specify in each case a fixed royalty to be paid by the successful bidder, in addition to any bonus offered for the lease, and all proceeds from leases shall be covered into the fund to which they shall properly belong, and no transfer or assignment of any lease shall be valid or confer any right in the assignee without the consent of the proper State authorities in writing: * * *.

Constitution of Oklahoma, Article XI:

SECTION 1. *State Accepts All Grants.*—The State hereby accepts all grants of land and donations of money made by the United States under the provisions of the Enabling Act, and any other Acts of Congress, for the uses and purposes and upon the conditions, and under the limitations for which the same are granted or donated; and the faith of the State is hereby pledged to preserve such lands and moneys and all moneys derived from the sale of any of said lands as a sacred trust, and to keep the same for the uses and purposes for which they were granted or donated.

Oklahoma Compiled Statutes of 1921:

SEC. 9415. *Commissioners to segregate public land containing oil and gas.*—When any tract of the school or other public lands, granted to the State of Oklahoma under the act of congress known as the "Enabling Act" is known by the commissioners of the land office of the State to contain oil or gas, or where such lands are, by said commissioners, deemed valuable for oil and gas purposes, such commissioners shall enter of record in their office their finding, declaring that such oil or gas character exists, and further declaring that the oil and the gas de-

posits are segregated from the surface use and interest therein, and such segregation of such deposits shall conclusively withhold the same from sale, lease, or other alienation, except as provided in this article.

SEC. 9417. *Lease of oil and gas interest.*—The oil and gas interest described in this article in such lands may be leased by the commissioners of the land office for oil and gas purposes to the same extent and in the same manner as a private owner of lands in fee could, in his own right, execute a grant thereto, subject, however, to the following limitations:

First. For a period not exceeding five years, with suitable provisions for preference right to release for a second term of five years at its expiration, at the maximum rate of rentals, royalties, and bonuses that may be obtained therefor, at the time of such renewal.

Second. Upon due advertisement and public notice of not less than thirty days, in such manner as the commissioners may, by rule, prescribe.

Third. Such leasing shall be done under public bids and awarded to the highest responsible bidder: Provided, that the commissioners of the land office shall have power to reject any and all bids.

SEC. 9423. *Disposition of funds from oil and gas lands.*—The proceeds derived in bonuses and royalties and from other inducements and considerations for the execution and operation of the oil and gas leases in this article provided, shall be carried in the several funds, for the use and benefit of which such lands were granted by the United States to the State of Oklahoma, and to the territory now comprising the area embraced

within the said State, under the provisions of the enabling act, and any and all other acts of Congress, for the uses and purposes, and upon the conditions, and under the limitations for which the same were granted; and the money resulting from such lease and from the operation thereof shall be handled, disposed of, and used in like manner as the other moneys belonging to said several funds under the laws of this State.

U. S. GOVERNMENT PRINTING OFFICE: 1907

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In the Supreme Court of the United States

OCTOBER TERM, 1931

No. 341

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner,

v.

CORONADO OIL AND GAS COMPANY

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE DISTRICT OF COLUMBIA

SUPPLEMENTAL BRIEF FOR THE PETITIONER ON REARGUMENT

This case is here upon reargument. The petitioner relies upon the argument in its original brief, and in support thereof desires to add the following:

In the original brief (pp. 27–30) we pointed out that in *Gillespie* v. *Oklahoma*, 257 U. S. 501, it was conceded that the lessee was an instrumentality of the Federal Government, and that this circumstance distinguished the case from the case now at bar, not only because we make no such concession

here but because the exemption of Federal agencies and instrumentalities is absolute, whereas state agencies and instrumentalities enjoy a qualified exemption dependent upon their employment for strictly governmental purposes. Consequently, the concession made in the *Gillespie case* serves to destroy the controlling effect given to it in the court below, and leaves open for consideration in the instant case the contention that the lessee's income from its own share of the royalties is not exempt from Federal income tax because the business from which such income is derived is not governmental in character.

The implied immunity from taxation of the States by the United States, and of the United States by the States, arises from the provisions of the Constitution which contemplate the maintenance of the independence of the national and state governments within their respective spheres. The reasons underlying the principle mark the limits of its range, and the immunity does not extend to anything lying outside or beyond governmental functions and their exertion. *Indian Motocycle Co.* v. *United States,* 283 U. S. 570, 575–576.

The Federal Government, possessing only those powers conferred upon it by the express grant of the Constitution, and such other powers as may be necessary or proper for carrying them into execution, can not lawfully exercise any power which is not governmental. Within the limits of its sov-

ereignty, defined by the Constitution, the power of the national government is supreme, and it follows necessarily that all of its activities are entitled to absolute immunity from state taxation.

When the doctrine of implied immunity was first formulated, in *McCulloch* v. *Maryland,* 4 Wheat. 316, 436, it was declared:

> * * * the states have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control, the operations of the constitutional laws enacted by congress to carry into execution the powers vested in the general government.

And in *California* v. *Pacific Railroad Co.,* 127 U. S. 1, 41, it was said:

> Recollecting the fundamental principle that the Constitution, laws and treaties of the United States are the supreme law of the land, it seems to us almost absurd to contend that a power given to a person or corporation by the United States may be subjected to taxation by a State. The power conferred emanates from, and is a portion of, the power of the government that confers it. To tax it, is not only derogatory to the dignity, but subversive of the powers of the government, and repugnant to its paramount sovereignty.

The same principle was stated in *Johnson* v. *Maryland,* 254 U. S. 51, 55–56:

> The decision in that case [*McCulloch* v. *Maryland*] was not put upon any considera-

> tion of degree but upon the entire absence of power on the part of the States to touch, in that way at least, the instrumentalities of the United States; 4 Wheat. 429, 430; and that is the law to-day. *Farmers & Mechanics Savings Bank* v. *Minnesota*, 232 U. S. 516, 525, 526.

Even in the *Gillespie case* it was said (p. 505): "The rule as to instrumentalities of the United States * * * is absolute in form." And in *Jaybird Mining Co.* v. *Weir*, 271 U. S. 609, 613, the same principle was emphasized: " * * * the federal government in all its activities is independent of state control."

In contrast, the powers of a State are both governmental and proprietary. Unlike the United States, it may exercise powers both of a governmental and of a nongovernmental character. In *Van Brocklin* v. *State of Tennessee*, 117 U. S. 151, 158, it was said:

> The United States do not and can not hold property, as a monarch may, for private or personal purposes. All the property and revenues of the United States must be held and applied, as all taxes, duties, imposts and excises must be laid and collected, "to pay the debts and provide for the common defence and general welfare of the United States."

The States, on the other hand, retain all the powers of a monarch except so far as they have been surrendered or limited by the provisions of

the Federal Constitution (*Hall* v. *Wisconsin*, 103 U. S. 5, 11), and may engage, directly or through agencies and instrumentalities, in activities governmental and nongovernmental in character. It follows that where the exemption from Federal taxation is predicated upon interference with the exercise of strictly governmental powers of the State, the inquiry must extend beyond the instrumentality sought to be taxed to its activities with which the imposition of the tax will interfere, and if these activities are not strictly governmental the tax will be sustained. (*South Carolina* v. *United States*, 199 U. S. 437, and authorities cited on page 30 of our original brief.)

Such inquiry in this case, we contend, discloses at once that the tax imposed upon income derived by the lessee from the sale of its own share of the oil and gas produced is imposed upon income derived by the lessee from the sale of its own property and the conduct of its own private business. It has been held that the State of Minnesota, in contracting for the removal of timber from lands received in its sovereign capacity under a grant from the United States to hold these in trust for its school fund, acts in its proprietary and not in its sovereign capacity. (*State* v. *Horr*, 165 Minn. 1, 5.) But in the case at bar we need not go so far. Assuming the lease to be an instrumentality of government, the lessee, in marketing its own share of the oil, does not act for the State in its sovereign

or governmental capacity. It acts solely on its own account, and for its own profit, in a purely private business undertaking.

The tax, being imposed upon the lessee's income from the sale of its own share of the oil and gas produced, is a tax not upon the lessee as the instrumentality of the State but upon the lessee's income or property. But taxation of the property of the agent is not always or generally taxation of the means. (*Clallam County* v. *United States*, 263 U. S. 341, 344; *Thomson* v. *Pacific Railroad*, 9 Wall. 579, 591.)

In *Susquehanna Power Co.* v. *Tax Commission*, 283 U. S. 291, this Court sustained a tax levied by the State of Maryland upon lands of a licensee of the Federal Power Commission. The Power Company there claimed that in constructing and operating its plant under a Federal license it was an agency or instrumentality of the Federal Government, and that the tax in question was impliedly prohibited by the Constitution. This Court said (pp. 294–295):

> Assuming, for present purposes, that the license of the Power Commission is a federal instrumentality, immune from taxation or other direct interference by the State, it does not follow that the property appellant uses in its power project is clothed with that immunity. The exemption of an instrumentality of one government from taxation by the other must be given such a practical con-

struction as will not unduly impair the taxing power of the one or the appropriate exercise of its functions by the other. *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, 523, 524.

With that end in view, the distinction has long been taken between a privilege or franchise granted by the Government to a private corporation in order to effect some governmental purpose, and the property employed by the grantee in the exercise of the privilege, but for private business advantage. * * *

The present case is not only controlled by the earlier decisions of this Court, but it would be difficult to suppose any case in which the adverse effect of a tax upon a governmental purpose would be more remote or attenuated, or in which the asserted immunity would more seriously impair the sovereign power of the State to tax, than in this one.

Once the lessee in the case at bar receives its share of the oil and gas produced under the terms of the lease, it is entitled to dispose of its oil and gas, without accountability to the State, as its own property. No tax is imposed upon the production of its share, much less upon the production of the share which the State is entitled to receive. The lessee may do what it pleases with its share of the oil and gas, and the income which it derives therefrom is derived from its own property. In principle there is no distinction between this case and

Group No. 1 Oil Corporation v. *Bass*, 283 U. S. 279.

For the reasons urged in this and in our original brief, we submit that such income is not immune from Federal taxation by reason of any exemption implied from the provisions of the Constitution of the United States.

CONCLUSION

The decision of the court below should be reversed.

Respectfully submitted.

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MARCH, 1932.

U. S. GOVERNMENT PRINTING OFFICE: 1932

FILE COPY

In the Supreme Court of the United States

OCTOBER TERM, 1931

NO. 341

DAVID BURNET, Commissioner of Internal Revenue,
Petitioner,
vs.
CORONADO OIL & GAS COMPANY,
Respondent.

On Writ of Certiorari to the Court of Appeals of the District of Columbia

BRIEF AND PRINTED ARGUMENT FOR RESPONDENT

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BRIEF AND PRINTED ARGUMENT FOR RESPONDENT

STATEMENT OF CASE

LEGISLATIVE HISTORY OF OKLAHOMA SCHOOL LANDS

Congressional Legislation

Section 3, subdivision 5, of the Oklahoma Enabling Act (34 Stat. L. 267, 269) required, as a condition of the State's admission into the Union, that in its constitution "provision shall be made for the establishment and maintenance of a system of public schools which shall be open to all the children of said State and free from sectarian control."

Section 7 of the Act granted to the State for the bene-

fit of the common schools the sections of land numbered 16 and 36, with certain exceptions, in every township in Oklahoma Territory, included in which was the land subsequently leased by the State to respondent.

Section 8 (Appendix A) provided that such of the granted lands as were valuable for oil or gas should not be sold prior to January 1, 1915, but might be leased by public competition, after not less than thirty days advertisement, to the highest responsible bidder for periods not exceeding five years; that the leasing should require and the advertisement specify a fixed royalty in addition to any bonus offered; that all proceeds from leases should be paid into the fund to which it belonged; that no transfer or assignment of any lease should be valid or confer any right in the assignee without the consent of the proper State authorities in writing; and that the State legislature might enact additional legislation not in conflict therewith governing such leases.

Section 9 (Appendix A) provided that the proceeds of the granted lands, if any when sold, should constitute a permanent school fund, the income from which should be used in the support of such schools.

Section 22 required "that the Constitutional Convention provided for herein shall, by ordinance irrevocable, accept the terms and conditions of this act."

Oklahoma Constitutional and Statutory Provisions

By article XI, section 1, Oklahoma constitution (Appendix B), the State accepted the grant for the uses and purposes, upon the conditions, and under the limitations specified in the Enabling Act, and pledged its faith to preserve and keep the lands and the proceeds thereof for the purposes for which they were granted. And, pursuant to section 22 of the Enabling Act, the Constitutional Convention of the State enacted an irrevocable ordinance accepting the terms and conditions of the Act (Appendix C).

Conforming to the 5th subdivision of section 3 of the Enabling Act, section 5 of article I of the State constitution provided that:

> "Provision shall be made for the establishment and maintenance of a system of public schools which shall be open to all the children of the State and free from sectarian control; and said schools shall always be conducted in English."

Further conforming to that requirement, article VI, section 1, of the State constitution created the office of Superintendent of Public Instruction, and made that officer a member of the executive department of the State. Article XVII, section 2, created the office of Superintendent of Public Instruction in each county of the State. Article XIII, sections 1 and 4, required that the legislature establish and maintain a system of free public schools wherein all the children of the State might be educated, and provide for

the compulsory attendance at some public or other school of all children in the State of sound mind and body between the ages of 8 and 16 years for at least three months in each year; and section 5 of that article vested the supervision of instruction in the public schools in a board of education composed of the Superintendent of Public Instruction, the Governor, the Secretary of State, and the Attorney General (Appendix C).

Article XI, sections 2 and 3, of the constitution (Appendix D) created a permanent school fund for the benefit of the common schools, consisting in part of the proceeds of the sale and the income from the leasing of the granted lands, and provided that the income therefrom should be apportioned among all the common school districts in the State in proportion to their scholastic populations.

Article VI, section 32, of the constitution created a branch of the executive department known as the Commissioners of the Land Office, composed of the Governor, the Secretary of State, the State Auditor, the Superintendent of Public Instruction, and the President of the Board of Agriculture, to which was given charge of the sale, rental, disposal and management of the school lands and other public lands of the State, and of the funds derived therefrom, under rules and regulations prescribed by the legislature (Appendix E).

The legislature of 1910 authorized the Commissioners

of the Land Office to make such rules and regulations governing the leasing of the public lands as they should deem proper, not in conflict with the Act (section 9401, Compiled Oklahoma Statutes 1921).

The first legislature enacted sections 9415, 9417, 9418 and 9423, Compiled Oklahoma Statutes, 1921 (Appedix F), providing that the Commissioners of the Land Office should ascertain and enter of record what portion of the granted lands were valuable for oil and gas, and that the same should be withheld from sale; that the oil and gas thereunder might be leased in the manner and for the period provided in the Enabling Act, the lessee to be required to drill a sufficient number of wells to offset the wells upon contiguous premises, to faithfully operate the leased lands for oil and gas, and to give a bond for the faithful performance of the terms of his lease; that no transfer or assignment of any lease should be valid or convey any right in the assignee without the consent in writing of the Commissioners of the Land Office; that the commissioners might make additional rules and regulations; and that the bonuses and royalties under such leases should be carried to the several funds for the benefit of which such lands were granted.

The legislature of 1917 enacted sections 9424 to 9430, inclusive, Compiled Oklahoma Statutes, 1921, containing substantially the same provisions as those just referred to (Appendix G).

It was under the foregoing constitutional and statutory provisions that the leases to respondent were executed, from the operation of which were derived the income and profits sought to be taxed.

Acts Done Pursuant to the Foregoing Constitutional and Statutory Provisions

December 4, 1913, the Commissioners advertised that, on January 9, 1914, they would receive sealed bids for the leasing for oil and gas purposes of a certain 480 acres of the granted land, for a term of five years, with preference right to re-lease for an additional like period, under the laws of Oklahoma and the rules and regulations of the Commissioners, at a royalty of fifty per cent of all oil and gas produced therefrom, and in addition such bonus as might be offered therefor; and that the terms of the lease to be executed should conform to and be governed and construed by and under the laws of the State and the rules and regulations of the Commissioners (R. 61-2).

Under statutory authority the Commissioners had adopted and printed rules and regulations for leasing the public lands for oil and gas purposes (R. 62-3). These required that the successful bidder give a bond approved by the Commissioners for the faithful performance of his contract and to develop the lands sufficiently to extract all the oil and gas thereunder with the least possible delay;

that all producing wells drilled on adjoining properties should be offset by corresponding wells on the leased tract; that a certified copy of pipe line runs and of all sales and shipments be furnished monthly on demand; that accurate information concerning the wells and their operation and management be furnished on demand to the Commissioners or to anyone authorized to act for them; and that the lease should conform to and be interpreted and construed by the laws of the State of Oklahoma and the rules of the Commission.

The lease (R. 67-72), modeled upon those prepared by the Interior Department for leasing lands in Osage Indian Reservation dealt with in *Indian Territory Illuminating Oil Company* v. *Oklahoma,* 240 U. S. 522, recites that in pursuance of the Constitution and the laws of the State of Oklahoma, the lessors, in consideration of the royalty, covenants, stipulations and conditions therein expressed, to be paid, observed and performed by the lessee, do thereby lease and let unto the lessee, its successors and assigns, for a term of five years, all oil deposits and natural gas in and under the land described. The lessee therein agreed to pay a royalty of fifty per cent of all oil and gas produced; to operate the wells at their full capacity; not to abandon or plug any well without the written consent of the Commissioners; to furnish the Commissioners certified copies of guage tickets, sales and shipments; to exercise diligence in drilling for oil and gas; to drill a sufficient number of

wells to offset each well drilled on adjoining premises; and to develop the lands as required by the laws of the State and the rules and regulations of the Commissioners. It was provided that the lease should in all respects be subject to the rules and regulations theretofore and thereafter lawfully prescribed by the Commissioners, and that neither the lease nor any interest therein should be sublet, assigned, or transferred without the consent of the Commissioners first obtained in writing. The lessee was given the preference right, upon the expiration of that lease, to re-lease the premises for a second term of five years at the maximum rentals, royalties and bonuses obtainable therefor at the time of such renewal.

The lessee gave a bond in the sum of $10,000 to the satisfaction of the Commissioners. Upon the expiration of that lease the Commissioners re-leased the premises to respondent for oil and gas purposes for another term of five years (R. 73-8).

Respondent's entire income sought to be taxed was earned and received in the operation of those two leases as the lessee, agency or instrumentality of the State in developing and operating its school lands for oil and gas purposes.

RESPONDENT'S PROPOSITIONS

I.

Respondent was a governmental agency or instrumentality of the State of Oklahoma for the development and operation of its State school lands.

II.

Under the Constitution of the United States neither a state nor the United States can tax the governmental agencies or instrumentalities of the other; and if the Revenue Acts of 1917, 1918 and 1919 are construed to impose a tax upon the income of this governmental agency and instrumentality of the State, then the same are to that extent void.

Specifically, a tax upon respondent's income derived from its operation of its State leases is a tax upon the leases themselves; and a tax upon the leases is a tax upon the power of the State to make the leases, and is therefore void.

ARGUMENT AND AUTHORITIES

I.

Respondent was a governmental agency or instrumentality of the State for the development and operation of its governmental lands for governmental purposes.

(a) The establishment and maintenance of free public schools and the fostering of education is a governmental function and duty of the State of Oklahoma.

While petitioner does not question the general proposition, nevertheless in his application for the writ he contends that the establishment and maintenance of public schools is not *strictly* a governmental function. No authorities are cited.

The purpose and aim of government is the happiness, welfare and prosperity of the people. It is only to secure these that "governments are instituted among men." In article III of the Northwest Ordinance, adopted by the Congress under the Articles of Confederation on July 13, 1787, for the government of the Northwest Territory, it is said:

> "Religion, morality and knowledge *being necessary to good government* and the happiness of mankind, schools and the means of education shall forever be encouraged."

Both the Oklahoma Enabling Act and the State constitution recognize and apply this as a governmental maxim, from which it follows that education is both a legitimate

object and an essential means of government, and its promotion is a governmental function. No one will assert that a republican form of government such as ours can endure or accomplish its purpose without a certain degree of education in at least a substantial majority of its citizens. The preservation of the government is a function of government, and the education of its children is essential to its preservation.

The Enabling Act in express terms required that the State, in its organic law, make the establishment and maintenance of free public schools a governmental function and duty; and, that the State might more effectually perform that function and duty, Congress granted to it for that purpose the very lands from the operation of which the income here in question was derived, and provided that such as were valuable for oil and gas should not be sold prior to January 1, 1915, but might be leased, and it prescribed the procedure for the leasing and certain of the terms and provisions of the leases.

Chapter 86, Compiled Oklahoma Statutes, 1921, deals with the public schools of the State. The entire State is divided into school districts, political subdivisions of the State, governed by boards of directors elected by the qualified electors at elections provided for by law. School districts have the governmental power to levy taxes, to issue bonds, to construct school buildings, to employ teachers,

and to determine the period of time, not less than three months, when schools shall be taught each year. Teachers are required to be examined and licensed.

The Oklahoma Supreme Court holds that the education of the children of the State is a "function of government", that it is "an imperative governmental duty to provide for and maintain a system of public education" (*Board of Education of the City of Ardmore* v. *State*, 26 Okla. 366, 370); that "the school district is but a subordinate agency of the State doing the work of the State" (*School District No. 17* v. *Zediker*, 4 Okla. 599, 603); that the establishment and maintenance of public schools, and even the furnishing of free transportation to and from the schools, is the exercise of a governmental function (*Consolidated School District No. 1* v. *Wright*, 128 Okla. 193).

In *State ex rel.* v. *Ross*, 76 Okla. 11, 13, the court said;

> "When organized, the public school districts, of whatever kind, are agencies of the State, prepared for and intended to discharge an important and imperative governmental duty, not only in the matter of education and the economic efficiency attendant thereon, but in a knowledge of our institutions, thereby tending to inculcate in the youthful mind a love of country and a respect for law and good government. There is no more sacred governmental duty than that arising out of our free public school system. Indeed, the very future of the republic may be rested very largely on the education of the youth of the land."

The decisions in other states are to the same effect:

Scown v. *Czarnecki*, 264 Ill. 305.
Landis v. *Ashworth*, 57 N. J. L. 509.
Ward v. *Flood*, 48 Cal. 36.
Piper v. *Big Pine School District*, 193 Cal. 664.
State v. *Powers*, 38 Ohio St. 54.
Howard v. *Tacoma School District*, 88 Wash. 167.
Long v. *Fuller*, 68 Penn. 170.
In re Rees' Appeal (Penn.), 12 Atl. 427, 430.
New Orleans v. *Salmen B. & L. Co.*, 135 La. 828.
Bissell v. *Davison*, 65 Conn. 183.
Kuhn v. *Thompson*, 168 Mich. 511.
Claybrook v. *City of Owensboro*, 23 Fed. 634.

Considering the purpose of government, and that in a government of and by the people the diffusion of knowledge among and the mental development of its citizens is necessary to the accomplishment of that purpose, the maintenance of public schools would seem as strictly governmental in its nature as the preservation of order, the judicial settlement of disputes, the preservation of health, and any other recognized governmental function. It is a means whereby, as this Court said in *Cochran* v. *Board of Education*, 281 U. S. 370, 375, "the common interest is safeguarded." It is not a new policy. It has always been regarded in the United States as one of the highest and most important of governmental functions. Public schools and universities were maintained and operated by the colonies from the earliest colonial times. (Nelsons' Encyclopedia, vol. 10, p. 891; The Americana, Vol. 27, History of Uni-

versity of Columbia; Vol. 29, p. 337; Ellwood P. Cubberly, "An Introduction to the Study of Education," pp. 1-4, 62-3, 357-8.) They were authorized by the colonial laws and the early State constitutions. (See the following from "The Federal and State Constitutions, Colonial Charters and Organic Laws of the United States," compiled in 1878 by Ben. Perley Moore by order of the United States Senate: Constitutions of Georgia, 1777, Art. LIV, p. 383; Massachusetts, 1780, Art. III, p. 957, Chap. V, p. 970; New Hampshire, 1784, p. 1291; North Carolina, 1776, Art. XLI, p. 1414; Vermont, 1777, sec XL, p. 1865; 1786, sec XXXVIII, p. 1874; 1793, sec 41, p. 1882; Pennsylvania Frames of Government, 1683, sec XII, p. 1521; 1696, p. 1535; Constitutions of 1776, sec. 44, p. 1547; 1790, Art. VII, p. 1553.)

In 1779 Thomas Jefferson introduced in the Virginia legislature his famous "bill for a more general diffusion of knowledge", embodying a plan for a public school system in that State. In his first message to Congress in 1790 Washington pointed out the importance of education for the maintenance of the security of the Constitution.

The fact that taxes are permitted to be levied and public moneys to be expended for the maintenance of public schools, that the department of education is made a branch of the executive department of the State, that numerous public officers and boards ranging from the State Superintendent of Public Instruction to district trustees are

elected and paid to carry on the public schools, just as officers are elected and paid to administer justice or carry on any other function of government, all show that the maintenance of public schools is a governmental function in every proper sense of the term. The United States claims no right to tax the salaries of public school teachers. It could not by any law levy a tax upon public school buildings, though the tax were apportioned among the several states in accordance with section 2 of article I of the Federal constitution.

Furthermore, Congress having expressly required the State, by its organic law, to make the establishment and maintenance of public schools a governmental function, it would seem that the United States cannot be heard to say that is not so.

(b) The lease was an instrumentality and respondent was an agency of the State in the performance of this governmental function.

Petitioner says that respondent's production and sale of oil and gas were not acts of government, but were only activities of a private nature, and that neither the production and sale of the oil nor the making of the leases between respondent and the State were directly connected with the operation of the schools.

The governmental function of maintaining public schools involves not only their establishment, but also the

raising of revenue to carry them on; and, under the Enabling Act and the constitution of the State, it was as much a governmental function of Oklahoma to obtain revenue for its public school fund from these governmental lands as it is to obtain such revenue for that purpose by taxation or by the issuance of bonds. The State's leasing power of these governmental lands for governmental purposes was as much a governmental power as is its taxing power or its power to issue bonds for school purposes; and the leases themselves were governmental instrumentalities.

The aim of Congress and the State was to raise money for public school purposes, and the lands and their development and operation through leases were intended to be a means to that end. In principle, there is no distinction between the governmental act of issuing bonds and the governmental act of leasing governmental lands. They are both done for the same purpose, to raise revenue. The purchase of a State bond, so far as the purchaser is concerned, is a mere act of private business. There is nothing essentially governmental in the issuance of bonds. Private business institutions issue them every day, and they are taxable. State bonds and the interest thereon are not taxable, not because of anything peculiar to bonds themselves, but because they are a governmental means of raising money, and to tax the bonds is to tax the power of the State to raise money. It is the power of the government to raise money for governmental purposes that is

protected. That an act is one which may be done by individuals or private corporations does not necessarily stamp it as non-governmental when done by government for a recognized governmental purpose.

In *McCulloch* v. *Maryland*, 4 Wheat. 316, the Bank of the United States, whose capital was privately subscribed, was held to be an agency or instrumentality of the United States, necessary and proper to carry into execution certain of its governmental powers, and therefore not taxable by a State. The operation of the bank was no more an act of government than was the development and operation of Oklahoma's school lands. It was as much an activity incident to carrying on a private business as was the development and operation of Oklahoma's school lands.

In *Weston* v. *Charleston*, 2 Pet. 449, the court held that the tax levied by the City of Charleston upon bonds issued by the United States owned within the city was "a tax upon the contract subsisting between the government and the individual", and therefore void. Here, is not the tax a tax upon the contract between the State and respondent, and therefore void? Was the individual owner of the bonds in that case performing any act of government?

In *Panhandle Oil Company* v. *Mississippi*, 277 U. S. 218, the tax was laid upon a private corporation engaged in distributing gasoline, certainly not an act of government, but only an ordinary private business, not immediately or

directly connected with the exercise of any governmental function. Yet it was held that a State tax levied against that company upon gasoline sold to the United States was void.

In *Indian Motorcycle Company* v. *United States,* not yet reported, the party taxed was a manufacturer and seller of motorcycles, certainly not acts of government, but only a private business; but it was held that the United States could not levy an excise tax upon its sale of a motorcycle to a municipal subdivision of the State.

In *Choctaw, Oklahoma & Gulf R. R. Co.* v. *Harrison,* 235 U. S. 292; *Indian Territory Illuminating Oil Co.* v. *Oklamoa,* 240 U. S. 522; *Howard* v. *Gypsy Oil Co.,* 247 U. S. 503; *Large Oil Company* v. *Howard,* 248 U. S. 549; *Gillespie* v. *Oklahoma,* 257 U. S. 501, and *Jaybird Mining Co.* v. *Weir,* 271 U. S. 609, the parties taxed were private corporations engaged in the production and sale of coal, oil, gas, lead and zinc, ordinarily private businesses; but this Court held that, because they were lessees of restricted Indian lands, they were agencies and instrumentalities of the federal government engaged in the performance of a governmental function, and as such were not taxable by the State.

Here the lands are owned by the State for a governmental purpose. It was intended that the State should derive a revenue from them for a governmental purpose,

and that this should be done through leases. The leasing of this land for that purpose was therefore as much the exercise of a governmental function as the levying of taxes or the issuance of bonds for the same purpose; and the State's lessee bears the same relation to the State that Gillespie, Jaybird Mining Company, Indian Territory Illuminating Oil Company and Choctaw, Oklahoma & Gulf R. R. Co., in the cases last cited, bore to the United States. Government can exercise its functions only through means or agencies designated to carry its powers into execution, and such means or agencies are governmental instrumentalities. It being contemplated that these governmental lands should be developed and operated for governmental purposes, respondent was but doing the work of the State in so developing and operating them. The State might have authorized the Commissioners of the Land Office directly, with tools and machinery belonging to the State, to drill and operate the lands, and in such case the United States could not have taxed any part of the oil produced or the proceeds thereof. If, however, under authority of Congress, the State by and through its leases employed respondent to do this work for it, and gave him a part of its untaxable oil and gas as compensation for so doing, can the United States complain? And is not a tax upon respondent's profits from the leases a tax upon the leases themselves, a tax upon the power of the State to execute

the leases, and a burden upon and a hindrance to the State's exercise of that power?

It is not contended that the State may engage in the oil and gas business generally, purchase lands and leases for that purpose, and, under such circumstances, clothe its lessees or agencies with immunity from federal taxation. The State has not attempted to do so. It has never purchased or leased a tract of land for the purpose of carrying on that business. It has confined itself to developing these governmental lands for governmental purposes, in strict compliance with the terms of the Enabling Act. In such situation the statement of this Court in *Sherman et al.* v. *United States*, 282 U. S. 25, involving the question whether the California Board of State Harbor Commissioners, in operating the State Belt Railroad, was subject to the Federal Safety Appliance Acts, is applicable:

> "California has not gone into the business generally as a common carrier, but simply has constructed the Belt Line as an incident of its control of the harbor—a State prerogative."

No pre-existing source of federal revenue is affected, as was the case in *South Carolina* v. *United States*, 199 U. S. 437, concerning which this Court said in *Murray* v. *Wilson Distillery Co.*, 213 U. S. 151, 173:

> "That case was concerned with the power of a State, by virtue of its legislation in regard to the sale and consumption of liquor, to destroy a pre-existing right of taxation possessed by the government of the United States."

A state's operation and development of its own lands for governmental purposes is not to be likened to its engaging in an ordinary business like that of selling intoxicating liquor. Here, in addition to the governmental purpose aimed at by both the United States and the State, the means of accomplishing it, the ownership, use and disposition of land, was the first, and has always been one of the highest, attributes of sovereignty. When William I conquered England, he took title as sovereign to all the soil, and parcelled it out among his lords and barons as his tenants, and the feudal system then established was based upon the ownership of the soil by the sovereign. The common law doctrine of wardship, the right of eminent domain, and the law of escheats all had their origin under this system and were based upon the sovereign's ownership of the land. The first act of an explorer discovering a new country has always been to claim the new land for his sovereign, and all titles have emanated from the sovereign. In the United States practically all early colonial charters and royal grants contained a provision that the granted land should be held of the sovereign by a common socage tenure, and it was not until after the states succeeded to the authority of the British government that these tenures were abolished. The legislature of New York abolished tenures in socage in capite in 1779. Most of the western states were dotted with land grants from the crown of Spain. All private titles to land within the United

States are derived ultimately from royal grants and from grants from the state or federal government.

The United States owns vast bodies of land. It has the same right of leasing as is incident to absolute ownership by an individual (*Mid-Northern Oil Company* v. *Walker*, 65 Mont. 414; *United States* v. *Gratiot*, 14 Pet. 526; *Hodgson* v. *Midwest Oil Company*, 297 Fed. 273). It may even reserve a part of the rent from leased lands in oil or other products (*Mid-Northern Oil Company* v. *Walker*, *supra*). The Act of February 25, 1920 (41 Stat. 437, c. 85, sec. 1-38), specifically provides for the leasing of lands owned by the United States containing coal, phosphate, oil and gas, oil shale and sodium, and provides for a royalty payable to the United States. If a State in leasing its public lands to obtain revenue for governmental purposes would not be acting in a governmental capacity, performing a governmental function, then the United States does not do so in leasing its lands under this act, and any State in which the land lies may tax the lease and the income of the lessee thereunder, without the consent of the United States and against its will.

Under the common law, in the light of which the Constitution of the United States as respects the proper governmental functions of the states must be interpreted (*South Carolina* v. *United States*, 199 U. S. 437, 449), mines of gold and silver, although on private lands, were the exclusive property of the crown, and did not pass in a

grant by the king under a general designation of lands or mines (*Moore* v. *Smaw*, 17 Cal. 199; *Hicks* v. *Bell*, 3 Cal. 219; *Esquimalt, etc., R. Co.* v. *Bainbridge* (1896), A. C. 561; *Atty. Gen.* v. *Morgan* (1891), 1 Ch. 432; *Lyddall* v. *Weston*, 2 Atk. 20, 26 Reprint 409; *Case of Mines*, Ployd. 310, 33 Reprint 1032, 22 E. R. C. 585; *British Columbia Atty. Gen.*, 14 App. Cas. 295); and, if metalliferous ores contained gold or silver worth extracting, but the ores could not be obtained without interfering with the gold or silver, the whole of such ores belonged to the crown. Except as limited by statute, the crown had the right to work not only gold and silver mines, but also all mines containing gold or silver worth extracting (*Atty. Gen.* v. *Morgan* (1891), 1 Ch. 432). The crown's ownership also extended to all mines and minerals in public reserves, other public lands and the beds of rivers (*Esquimalt, etc., R. Co.* v. *Bainbridge* (1896), A. C. 561; *Woolley* v. *Victoria Atty. Gen.*, 2 App. Cas. 1963). So that the ownership, leasing, and mineral development of land has been a power and function of sovereignty from earliest common law times, and is a very different thing from its engaging in the general private business of buying and selling intoxicating liquor for profit. Under the common law and throughout the history of the United States the former has always been recognized as a proper governmental function; the latter has not.

Certainly, therefore, respondent's leases were governmental instrumentalities; and respondent was a govern-

mental agency of the State for the performance of a proper governmental function, just as were Gillespie, Jaybird Mining Company and Indian Territory Illuminating Oil Company, in the cases heretofore cited, agencies of the United States. The test is not whether such agencies are engaged in a business in which private persons and corporations also engage, but whether the government, by and through them, is performing a proper governmental function.

These lands having been granted for a governmental purpose, and the duty to devote them and the revenue from them to carrying out that purpose having been created by compact between the United States and the State, the provisions of the Enabling Act accepted in the State constitution, the lands were dedicated to this governmental purpose, and their leasing was made a governmental function. The power to tax is the power to destroy; and it would be peculiar if the United States, after granting these lands to the State, and providing that the State might lease them for the governmental purposes stated, should now be held to have the power to destroy the very leases which it authorized and the leasing power which it required the State to assume and exercise. The grant was full and complete for the purpose stated, and the power does not exist in the United States to retake or destroy that which it granted, or to hinder or burden the State's exercise of the governmental power provided for.

II.

Under the Constitution of the United States delegating to it certain powers of government and reserving to the States those not delegated, and intending that each shall exercise its powers so delegated and reserved without hindrance or obstruction by the other, neither a State nor the United States can tax the property or the governmental functions, agencies or instrumentalities of the other. A tax upon respondent's income derived from its State leases is a tax upon the leases themselves, and a tax upon the leases is a tax upon the power of the State to make them, and interferes with the exercise of and may be used to destroy the power. Such a tax is a direct burden upon and interference with the State's exercise of a proper governmental function, the leasing of its school land to obtain revenue for public school purposes. For these reasons, if the revenue acts are construed to apply to respondent's income thus derived, they are to that extent unconstitutional and void.

The 16th Amendment did not extend the taxing power of the United States to new or excepted subjects, but only abrogated the requirement in section 2, Article I of the Constitution, that direct taxes be apportioned among the several states (*Brushaber* v. *Union Pac. R. R. Co.*, 240 U. S. 1, 17-19; *Stanton* v. *Baltic Mining Co.*, 240 U. S. 103; *Peck & Co.* v. *Lowe*, 247 U. S. 165, 172; *Evans* v. *Gore*, 253 U. S. 245); so that the power of the United States to tax the powers and functions of a State and the agencies and instrumentalities through which it carries them into execution is no greater now than it was before the adoption of that amendment.

In the first case dealing with the subject, *McCulloch* v. *Maryland*, 4 Wheat. 316, the court said:

"That the power to tax involves the power to destroy; that the power to destroy may defeat and render useless the power to create; that there is a plain repugnance in conferring on one government a power to control the constitutional measures of another, which other, with respect to those very measures, is declared to be supreme over that which exerts the control, are propositions not to be denied."

And in *Weston* v. *Charleston*, 2 Pet. 449, involving a tax upon bonds issued by the United States, the court said:

"The tax in question is a tax upon the contract subsisting between the government and the individual. It bears directly upon that contract while subsisting and in full force. The power operates upon the contract the instant it is framed, and must imply a right to affect that contract * * *.

"If the right to impose the tax exists, it is a right which in its nature acknowledges no limits. It may be carried to any extent within the jurisdiction of the state or corporation which imposes it, which the will of each state and corporation may prescribe * * *.

"The right to tax the contract to any extent when made must operate upon the power to borrow before it is exercised and have a sensible influence on the contract. The extent of this influence depends on the will of a distinct government. To any extent, however inconsiderable, it is a burden on the operations of government. It may be carried to an extent which shall arrest them entirely."

See also:

Bank of Commerce v. *New York*, 2 Black 620.
Dobbins v. *Commissioners*, 16 Pet. 435.
Bank Tax Case, 2 Wall. 200.
The Banks v. *The Mayor*, 7 Wall. 16.
The Collector v. *Day*, 11 Wall. 113.

United States v. *Railroad Company*, 17 Wall. 322.
Telegraph Co. v. *Texas*, 105 U. S. 460.
California v. *Central Pac. R. R. Co.*, 127 U. S. 1.
Wisconsin Central R. R. Co. v. *Price Co.*, 133 U. S. 496.
Pollock v. *Farmers Loan & Trust Co.*, 157 U. S. 429.
Ambrosini v. *United States*, 187 U. S. 1.
Home Savings Bank v. *Des Moines*, 205 U. S. 503.
Williams v. *Talladega*, 226 U. S. 404.
Farmers & Mechanics Sav. Bank v. *Minnesota*, 232 U. S. 516.
Choctaw, Oklahoma & Gulf R. R. Co. v. *Harrison*, 235 U. S. 292.
Indian Territory Illuminating Oil Co. v. *Oklahoma*, 240 U. S. 522.
Evans v. *Gore*, 253 U. S. 245.
Gillespie v. *Oklahoma*, 257 U. S. 501.
Childers v. *Beaver*, 270 U. S. 555.
Jaybird Mining Co. v. *Weir*, 271 U. S. 609.
Northwest Mutual Life Ins. Co. v. *Wisconsin*, 275 U. S. 136.
National Life Ins. Co. v. *United States*, 277 U. S. 508.
Panhandle Oil Co. v. *Mississippi*. 277 U. S. 218.
Indian Motorcycle Co. v. *United States*, — U. S. —.
Group No. 1 Oil Corporation v. *Bass*, 283 U. S. 279.

The exemption from such taxation is mutual and reciprocal. The property and governmental functions of a state and the means and agencies through which it elects to perform them are as free from taxation by the federal government as those of the latter are from taxation by the states,

and for the same reasons. In *Dobbins* v. *Commissioners*, 16 Pet. 435, the court said:

> "There is a concurrent right of legislation in the states and the United States, except as both are restrained by the Constitution of the United States. Both are restrained upon this subject by express prohibition in the Constitution."

In *United States* v. *Railroad Company*, 17 Wall. 322, it is said:

> "The right of the States to administer their own affairs through their legislative, executive, and judicial departments, in their own manner through their own agencies, is conceded by the uniform decisions of this court and by the practice of the Federal government from its organization. This carries with it an exemption of those agencies and instruments from the taxing power of the Federal government. If they may be taxed lightly, they may be taxed heavily; if justly, oppressively. Their operation may be impeded and may be destroyed, if any interference is permitted. Hence, the beginning of such taxation is not allowed on the one side, is not claimed on the other."

In *The Collector* v. *Day*, 11 Wall. 113, the court said:

> "The general government and the States, although both exist within the same territorial limits, are separate and distinct sovereignties, acting separately and independently of each other, within their respective spheres. The former in its appropriate sphere is supreme; but the states within the limits of the powers not granted, or, in the language of the tenth amendment, 'reserved,' are as independent of the general government as that government within its sphere is independent of the States * * *.

"Such being the separate and independent condition of the States in our complex system as recognized by the Constitution, and the existence of which is so indispensable that, without them, the general government itself would disappear from the family of nations, it would seem to follow, as a reasonable, if not necessary consequence, that the means and instrumentalities employed for carrying on the operations of their governments, for preserving their existence, and fulfilling the high and responsible duties assigned to them in the Constitution, should be left free and unimpaired, should not be liable to be crippled, much less defeated by the taxing power of another government, which power acknowledges no limits but the will of the legislative body imposing the tax * * *.

"The supremacy of the general government, therefore, so much relied on in the argument of the counsel for the plaintiff in error, in respect to the question before us, cannot be maintained. The two governments are upon an equality, and the question is whether the power 'to lay and collect taxes' enables the general government to tax the salary of a judicial officer of the State, which officer is a means or instrumentality employed to carry into execution one of its most important functions, the administration of the laws, and which concerns the exercise of a right reserved to the States?"

In *Pollock* v. *Farmers Loan & Trust Company*, 157 U. S. 429, 583, the court said:

"The Constitution contemplates the independent exercise by the Nation and the States, severally, of their constitutional powers.

"As the States cannot tax the powers, the operations, or the property of the United States, nor the means which they employ to carry their powers into execution, so it has been held that the United States

have no power under the Constitution to tax either the instrumentalities or the property of a State."

Even in the dissenting opinion in that case it was said:

> "The instrumentalities employed by the States in execution of their powers are not subjects of taxation by the general government, any more than the instrumentalities of the United States are the subjects of taxation by the States" (p. 562).

In *Evans* v. *Gore*, 253 U. S. 245, 255, the court, referring to the decisions just cited, said:

> "None of those decisions was put on any express prohibition in the Constitution, for there is none; but all recognized and gave effect to a prohibition implied from the independence of the States within their own spheres."

In *Group No. 1 Oil Corporation* v. *Bass*, 283 U. S. 279, the court said:

> "Property sold or otherwise disposed of by the government, either State or National, in order to raise revenue for government purposes, is in a broad sense a government instrumentality, with respect to which neither the property itself before sale nor its sale by one government, may be taxed by the other."

In *Indian Motorcycle Co.* v. *United States*, — U. S. —, it is said:

> "It is an established principle of our constitutional system of dual government that the instrumentalities, means and operations whereby the United States exercises its governmental powers are exempt from taxation by the States, and that the instrumentalities, means and operations whereby the States exert the

governmental powers belonging to them are equally exempt from taxation by the United States. This principle is implied from the independence of the national and state governments within their respective spheres and from the provisions of the Constitution which look to the maintenance of the dual system. *Collector* v. *Day*, 11 Wall. 113, 125, 127; *Willcutts* v. *Bunn*, 282 U. S. 216, 224-225. Where the principle applies it is not affected by the amount of the particular tax or the extent of the resulting interference, but is absolute. *McCulloch* v. *Maryland*, 4 Wheat. 316, 430; *United States* v. *Baltimore and Ohio R. R. Co.*, 17 Wall. 322, 327; *Johnson* v. *Maryland*, 254 U. S. 51, 55-56; *Gillespie* v. *Oklahoma*, 257 U. S. 501, 505; *Crandall* v. *Nevada*, 6 Wall. 35, 44-46."

In the case at bar, a tax on respondent's income as a lessee and agency of the State for developing these governmental lands and making available for governmental uses the revenue intended to be derived from them, is a tax upon the lease itself, a tax upon the State's contract, operates upon the State's power to make the contract, implies a right to affect the contract, and impairs the State's power to contract advantageously. If the right to impose the tax exists, it may be carried to an extent which would destroy the State's power to lease its lands at all.

If the source of the income is not taxable, then the income itself is not taxable. As said in *Oahu Ry. & Land Co.* v. *Pratt*, 14 Hawaii 126, cited with approval by this court in *Gillespie* v. *Oklahoma*, 257 U. S. 501, 506, "a tax on income is in substance and effect a tax on the property

producing the income, and income derived from property exempt from taxation is also exempt."

In *Choctaw, Oklahoma & Gulf R. R. Co.* v. *Harrison*, 235 U. S. 292, the leased land was the property of the Choctaw and Chickasaw Tribes, as here it was the property of the State. The Curtis Bill (Act of June 28, 1898, c. 517, 30 Stat. 495), provided for the allotment of the lands of the Five Civilized Tribes in Indian Territory in severalty among their respective members. The Act reserved the coal lands in the Choctaw and Chickasaw Nations from allotment, provided that the coal thereunder should be the common property of all the members of those two tribes, that the President should appoint two trustees to lease the same, subject to the approval of the Secretary of the Interior, and that the revenues therefrom should "*be used for the education of the children of Indian blood of the members of said tribes.*" Choctaw, Oklahoma & Gulf Railroad Company leased certain of those lands, and developed and operated its lease. A statute of Oklahoma levied a gross revenue tax upon all persons and corporations engaged in mining coal in the State, which was sought to be applied to Choctaw, Oklahoma & Gulf R. R. Co. This court held that the agreement with the Indians imposed a definite duty upon the United States in respect to the operation of the coal mines, and that the coal lessee "is an instrumentality through which this obligation is being car-

ried into effect. Such an agency cannot be subjected to an occupation or privilege tax by a state."

In *Indian Territory Illuminating Oil Company* v. *Oklahoma*, 240 U. S. 522, the Osage Tribe of Indians, under authority of an act of Congress, had executed oil and gas leases upon certain lands in the Osage Nation, now Osage County, Oklahoma. One of those leases had been assigned to Indian Territory Illuminating Oil Company, a private corporation. Oklahoma assessed a tax against that corporation measured by the value of its stock, which in turn was measured by the value of its lease. The State Supreme Court sustained the tax, holding that the company was not a federal agency, that it was a corporation for profit "with which the federal government found it convenient or profitable to deal in carrying out its policy toward the Osage Tribe of Indians. What the State is attempting to do is to tax the property of this corporation within its borders. This certainly is a proper exercise of the taxing power" (*In re Indian Territory Illuminating Oil Co.*, 43 Okla. 307). On appeal this court reversed that decision saying:

> "A tax upon the leases is a tax upon the power to make them, and could be used to destroy the power to make them. If they cannot be taxed as entities, they cannot be taxed vicariously by taxing the stock, whose only value is their value, or by taking the stock as evidence or measure of their value, rather than by directly estimating them as the Board of Equalization and the referee did."

In that case, did the Osage Nation, acting under authority of Congress, exercise any different power in executing the leases from that exercised by the Commissioners of the Land Office, acting under authority of an act of the legislature? Is the governmental power exercised any more sacred in the one case than in the other?

Upon the authority of Choctaw, Oklahoma & Gulf R. R. Co. v. Harrison and Indian Territory Illuminating Oil Company v. Oklahoma, this court affirmed, *per curiam*, judgments of the District Court of the United States for the Western District of Oklahoma in four cases, in which that court enjoined the State Auditor of Oklahoma from collecting the tax assessed upon leases on Indian lands (*Howard* v. *Gypsy Oil Co.*, 247 U. S. 503), and in *Large Oil Co.* v. *Howard*, 248 U. S. 549, reversed another decision of the Supreme Court of Oklahoma similar to that rendered by it in Indian Territory Illuminating Oil Company's case.

Gillespie v. *Oklahoma*, 257 U. S. 501, dealt with the right of the State to levy and collect an income tax upon the net income of persons derived from the operation of leases on restricted Indian lands. Except that in the case at bar the tax was levied by the federal government, and in the Gillespie case it was levied by the state government, the two cases are exactly alike. There Gillespie owned oil and gas leases on lands of individual Creek and Osage In-

dians restricted against sale or incumbrance. Chapter 164, Session Laws of Oklahoma, 1915, levied an annual State tax upon the entire net income, in excess of $3,000, of all persons within the State arising or accruing from all sources. Gillespie contended that, as a lessee of restricted Indian lands, he was an agency of the United States and that his income so derived was not subject to taxation by the State. The State contended, and its Supreme Court held, that the tax was not levied upon the Indians' income or share of the proceeds from the leases, but only upon the lessee's private share, and that the tax was therefore valid (81 Okla. 103). This court reversed the decision, saying:

> "The rule as to instrumentalities of the United States on the other hand is absolute in form and at least stricter in substance. *Williams* v. *Talladega*, 226 U. S. 404, 416, 417, 419. *Johnson* v. *Maryland*, 254 U. S. 51, 55. 'A tax upon the leases is a tax upon the power to make them, and could be used to destroy the power to make them.' 240 U. S. 530. The step from this to the invalidity of the tax upon the income from the leases is not long.
>
> "In cases where the principal is absolutely immune from interference an inquiry is allowed into the sources from which net income is derived, and if a part of it comes from such a source the tax is *pro tanto* void. *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429; 158 U. S. 601; a rule lately illustrated by *Evans* v. *Gore*, 253 U. S. 245, and applied in a case somewhat like the present by the Supreme Court of Hawaii. *Oahu Ry. & Land Co.* v. *Pratt*, 14 Hawaii 126. Whether this property could be taxed in any other form or not, it cannot be reached as profits or income from leases such

as those before us. The same considerations that invalidate a tax upon the leases invalidate a tax upon the profits of the leases, and, stopping short of theoretical possibilities, a tax upon such profits is a direct hamper upon the effort of the United States to make the best terms that it can for its wards. *Weston* v. *Charleston*, 2 Pet. 4429, 468 (p. 505-6)."

Here the State of Oklahoma and its lands were immune from taxation by the United States. The State's power to lease its school lands was immune from taxation by the United States. The lease itself was immune from taxation by the United States, because the power to tax it is the power to destroy it, which power does not exist in the United States. Therefore, the State, the land, the function of obtaining revenue from it, the governmental power of making the leases, and the leases themselves, all being exempt from taxation by the United States, upon what theory can the income be taxed? If "the same considerations that invalidate a tax upon the leases invalidate a tax upon the profits of the leases", then the income from the leases cannot be taxed unless the leases themselves are taxable. If the State's income tax upon Gillespie was "a direct hamper upon the effort of the United States to make the best terms that it can for its wards", then a tax upon the income from these leases is a direct hamper upon the right, power and governmental duty of the State to make the best terms that it can for its wards, the children of the State, to fit whom for citizenship is one of its highest gov-

ernmental duties, and was exactly the duty which the United States was undertaking to perform for the Indians.

Then came *Childers, State Auditor*, v. *Beavers*, 270 U. S. 555, which denied the power of the State to levy an inheritance tax upon the descent of a Quapaw Indian's allotment.

In *Jaybird Mining Co.* v. *Weir*, 271 U. S. 609, the company held a lead and zinc mining lease upon lands of a Quapaw allottee, approved by the Secretary of the Interior. Under that lease it had produced lead and zinc ores which were in its bins at the mine on January 1, 1921. The ores were assessed for ad valorem taxes which the mining company paid under protest. In a suit to recover the tax paid, this court said:

> "The lessee is an agency or instrumentality employed by the government for the development and use of the restricted land and to mine ores therefrom for the benefit of its Indian wards."

The court further said that "the lease was made to secure the development of the land and obtain for the benefit of the restricted Indian owners a percentage of the gross proceeds of the ores to be mined", and it held the tax void.

The governmental power or function which the United States was exercising in behalf of the Indians, constituting the basis of the decisions noted above, was of the same

character as that which the State was exercising in behalf of its children in making the leases here in question, and was exercised to accomplish exactly the same purpose, that is, to fit and prepare the Indians on the one hand and the children on the other for the duties and responsibilities of citizenship. The entire plan of allotting the lands of the Five Civilized Tribes among their members in severalty and of restricting those lands for a time against alienation, was intended, comprehensively, to break up community holdings, teach the Indians the dignity and necessity of labor, inculcate in them the habits of thrift, make them independent and self-supporting, and fit them for citizenship in the State intended presently to be formed out of that territory; in short, to educate them into competent citizens of the State and of the United States. *Woodward* v. *de Graffenreid,* 238 U. S. 284, 309; *U. S.* v. *Rickert,* 188 U. S. 432, 437.

ANSWER TO PETITIONER'S ARGUMENT

I.

Petitioner's contention that the effect of the tax is too indirect and too remote to interfere with any governmental function of the State.

If that is true, then the State's income tax upon Gillespie was too indirect and too remote to interfere with any function of the United States.

Gillespie and respondent were each doing exactly the same thing in the same way, and were each doing it for government to accomplish a governmental purpose. The only difference is that the former was an agency of the United States, while the latter was an agency of the State. Gillespie v. Oklahoma, therefore, rules this case, if, as said in the Metcalf & Eddy case, and in *Dobbins* v. *Commissioners*, 16 Pet. 435; *United States* v. *Railway Company*, 17 Wall. 322; *The Collector* v. *Day*, 11 Wall. 113; *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, and *Indian Motorcycle Company* v. *United States*, — U. S. —, the powers of the United States and of the State to tax each others instrumentalities are limited "in a similar manner." Each of those agencies, being impressed with the same character and entrusted with the same duties in relation to their governmental principals, has the same correlative exemption from taxation, unless an exemption is accorded to the federal government which is to be denied to the state; unless the powers reserved to the states for their preservation and for fulfilling the purposes of their governments are less sacred than those delegated to the United States, and may be destroyed by congressional legislation and the states be reduced from their sovereign stations to mere geographical units or counties of the United States.

Petitioner says that the tax is not laid upon the State, that it is laid upon respondent, a private corporation organized for private profit.

A tax upon the income from the lease is a tax upon the lease itself (*Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, 553; *Gillespie* v. *Oklahoma*, 257 U. S. 501), just as a tax upon the interest on a government bond is a tax upon the bond itself. And a tax upon the lease is a tax upon the State's power to execute the lease, and may be used to destroy the power (*Indian Territory Illuminating Oil Co.* v. *Oklahoma*, 240 U. S. 522). The tax is therefore laid upon the State. Its effect is to burden and obstruct the State in its performance of a governmental function. Is it to be supposed that the State could lease this land for a royalty of 50 per cent, as was done here, if it were known that the lessee's profit might be subjected to a surtax as high as 65 per cent in addition to the normal tax? The Secretary of the Interior annually leases lands in the Osage Nation at public auction, for which he receives for the benefit of the Osages bonuses running into many hundreds of thousands of dollars and royalties much higher than are obtainable for leases upon privately owned lands. Were those leases and the income therefrom subject to State taxation, the bonuses and royalties obtainable would be substantially decreased.

Moreover, as to these leases, respondent was more than a mere private corporation or private oil operator, in that it was impressed with an active duty in relation to the governmental purpose of the State, the performance of which in the State's behalf would be obstructed, indeed,

could be wholly prevented, by federal taxation. Both Gillespie and Indian Territory Illuminating Oil Company were also private persons and corporations operating for private profit, but they were not taxable by the State upon their governmental leases or the income therefrom.

Petitioner's argument is exactly that made by the Supreme Court of Oklahoma and rejected by this court. *In re Indian Territory Illuminating Oil Company,* 43 Okla. 307, 319, the Supreme Court of Oklahoma said:

> "Primarily this company is not a federal agency. It is a corporation for profit, incorporated under the laws of the State of New Jersey, and doing business in the State of Oklahoma, with which the federal government finds it convenient or profitable to deal in carrying out its policy toward the Osage tribe of Indians. What the State is attempting to do is to tax the property of this corporation within its borders. This certainly is a proper exercise of the taxing power of the State."

And in the Gillespie case the State did not attempt to tax the royalty payable by Gillespie to the Indians, but only to tax the income "derived from the lessee's private personal share of oil and gas produced under departmental leases upon restricted Indian lands" (81 Okla. 103). But this court held that both Indian Territory Illuminating Oil Company and Gillespie were instrumentalities of the United States, and that neither their leases nor the income therefrom were taxable by the State. The fact that a governmental agency is an individual or private corpo-

ration, and that the inducement to his or its becoming a governmental instrumentality is the hope of private gain, has nothing to do with the determination of the right of taxation. Holders of government bonds are private persons or corporations. United States Marshals, District Attorneys, and other public officers are private individuals, who accept their offices in many cases for the sake of the salary, private gain; but in their relation to the government they are more than mere private persons, and their salaries are not taxable by the states.

Petitioner says that the tax is not laid upon respondent's operations, or upon its gross receipts from oil and gas produced, or upon the making of the lease, but is laid upon its net income derived from all its business; and that the tax is not discriminatory, in that it is laid upon the net income of all corporations similarly situated.

If that reasoning is applicable here, then it was equally so in the Gillespie case. This court has determined that a tax upon the income from the lease is a tax upon the power of the State to make the lease. The tax is, therefore, laid upon the making of the lease. The facts that the tax is laid upon respondent's net income derived from all its business and is not discriminatory are not tests of its validity. Those facts were true of Oklahoma's income tax sought to be applied to Gillespie. Property or income exempt from taxation under the Constitution cannot be taxed

merely by using words embracing all property and all income (*Northwestern Mutual Life Insurance Company* v. *Wisconsin*, 275 U. S. 136; *National Life Insurance Company* v. *United States*, 277 U. S. 508; *Farmers & Mechanics Savings Bank* v. *Minnesota*, 213 U. S. 516; *Home Savings Bank* v. *Des Moines*, 205 U. S. 503). Such a "tax is *pro tanto* void."

Heiner v. *Colonial Trust Company*, 275 U. S. 232, is cited as sustaining a tax which might have "some perceptive economical effect on the Indians"; but that case is without application because there the federal government was taxing its own instrumentality. The court stated that it was beyond the State's power to tax the lessee's income because he was a federal instrumentality, but that the power of the United States to tax its own instrumentalities, if it elected to do so, was undoubted.

Petitioner cites *Flint* v. *Stone Tracy Co.*, 220 U. S. 107. The tax there considered was the corporation tax of 1909, and this court held that it was not a direct tax but an excise on the privelege of doing business in a corporate capacity.

Group No. 1 Oil Corporation v. Bass, 283 U. S. 279, is next cited

That decision turned wholly upon the nature and effect of an oil and gas lease under the laws of Texas, which is

fundamentally different from that of such an instrument in Oklahoma.

In Texas ordinary commercial oil and gas leases are held to be conveyances of an estate in the land and of the oil and gas in place. As to the University lands, the State constitution required the legislature to dispose of them by sale only, and the Texas Supreme Court held that so-called leases of them were in fact "present sales to the lessees of the oil and gas in place." That being true, this court, applying the settled principle that property purchased from the United States or from a state, which has completely passed from the government to the purchaser, becomes a part of the common mass of property and subject to its common burdens, the income from which is none the less taxable because it was acquired from the government, held that the title to the oil and gas in place had completely passed from the State to Group No. 1 Oil Corporation, that the latter owned it in place before it produced it, and that therefore it could claim no immunity from taxation with respect to it.

That is not the case here. In Oklahoma an oil and gas lease is an entirely different thing. In Oklahoma oil and gas, while in the earth, unlike solid minerals, are not the subject of ownership distinct from the soil; an oil and gas lease conveys no estate in the land, does not convey the oil and gas in place, is not a present conveyance of the oil

or gas. It only grants the right to explore for oil and gas and to produce the same from the land, and no title to those substances vests in the lessee until he has brought them to the surface and reduced them to possession.

In *Kolachny* v. *Galbreath*, 26 Okla. 772, the Supreme Court of Oklahoma, passing upon the nature and effect of an oil and gas lease in that State, said:

> "The lease relied upon by the plaintiff does not vest in him the title to the oil and gas in said land, and is not a grant of any estate therein, but is simply a grant of a right to prospect for oil and gas, no title vesting until such substances are reduced to possession by extracting same from the earth—an incorporeal hereditament."

In *Frank Oil Company* v. *Belleview Gas & Oil Company*, 29 Okla. 719, the court said:

> "In *Kolachny* v. *Galbreath et al.*, 26 Okla. 772, it was held that:
>
> " 'Oil and gas, while in the earth, unlike solid minerals, are not the subject of ownership distinct from the soil, and the grant of the oil and gas, therefore, is a grant, not of the oil that is in the ground, but of such a part as the grantees may find, and passes nothing that can be the subject of an ejectment or other real action.'
>
> "And that:
>
> " 'Ejectment will not lie to recover possession of the land covered by such lease against the lessor or his grantee when the lessee has never had possession under said lease.'
>
> "In addition to the authorities cited in support of that conclusion, attention is called to *Backer* v. *Penn*

Lubricating Co., decided by the United States Circuit Court of Appeals for the Sixth Circuit, June 18, 1908 (162 Fed. 627, 89 C. C. A. 418), the opinion being written by Knappen, District Judge, concurred in by Lurton and Richards, Circuit Judges, wherein it is said:

"'The law seems to be settled that, under a lease, of the nature here in question, title to the oil in place is not in the lessee.'

"The lease, under these decisions, does not have the effect of placing the title of the oil and gas that is under the surface of the land in controversy in the lessee, but to grant to the lessee the privilege of exploiting for the oil and gas."

In *Duff* v. *Keaton*, 33 Okla. 92, the court held that an oil and gas lease is not a sale of realty, that in leasing the lands of a minor it is not necessary to follow the statutory procedure for the sale of such lands, and that an oil and gas lease in Oklahoma is personal property. The court then said:

"The rule seems to be settled in this jurisdiction that the grant of an exclusive privilege to go upon land for the purpose of exploring for oil or gas, the grantor to receive part of the oil or gas mined, does not vest in the grantee any estate in the land or oil or gas, but is merely a license or grant; such a lease creating an incorporeal hereditament only, and the lessee having no right or title to the oil or gas lying under the surface of the land. This, under our statute is simply a chattel real."

In *Garfield Oil Company* v. *Champlin et al.*, 78 Okla. 91, the fifth syllabus by the court is as follows:

"Under the decisions of this state, oil and gas, while in the earth, unlike solid minerals, are not subject to

ownership distinct from the soil, and the grant of the oil therefore is a grant, not of the oil that is in the ground, but of such a part as the grantee may find."

In *Hitt* v. *Henderson*, 112 Okla. 194, the court said:

"Many decisions of this court have announced the rule to the effect that the right or interest created by an oil and gas lease creates only the right to explore for and take from the earth any oil and gas found; that the lessee acquires no vested estate in the premises prior to the discovery of oil or gas. *Brennan* v. *Hunter;* 68 Okla. 112, 172 Pac. 48; *Garfield Oil & Gas Co.* v. *Champlin*, 78 Okla. 91, 189 Pac. 514; *First National Bank of Healdton* v. *Dunlap*, decided Jan. 22, 1924 (pending on rehearing).

"In *Brennan* v. *Hunter, supra*, it is held in the fifth paragraph of the syllabus that:

"'An oil and gas lease is not a grant of the oil and gas that is in the ground, but of such part thereof as the lessee may find, and passes no estate that can be the subject of an ejectment or other real action.'"

The Texas constitution required "the legislature to dispose of the University lands by sale only", which means that the legislature was forbidden to grant or authorize the grant of a license to explore and operate the lands for oil and gas purposes. It was required to pass title, to vest an estate in the land. On the other hand, the Oklahoma Enabling Act forbade the State to sell these lands prior to January 1, 1915, but expressly authorized their leasing for oil and gas purposes. So that, while in Texas the State is forbidden to lease University lands for oil and gas purposes, as the term lease is understood in Oklahoma, and is

empowered only to sell, in Oklahoma the State was forbidden to to sell prior to January 1, 1915, and was empowered only to lease.

Respondent was no more a purchaser from the State of the oil and gas under the lands described in its leases than were Indian Territory Illuminating Oil Company and Gillespie purchasers of the oil and gas under their leases. In the Group No. 1 Oil Corporation case it was said that, where restricted Indian property, either real or personal, had passed to a purchaser by a completely executed act of sale, without restriction, and no interest in it had been retained for the benefit of the Indians, the State might tax it. Since, however, the State's right to tax was denied in the Indian Territory Illuminating Oil Company and Gillespie cases, it is evident that the leases in those cases were not considered as vesting title in the lessee to the oil and gas in place; otherwise, the lessee would have had the same status as that of Group No. 1 Oil Corporation, and their leases and the income therefrom must have been held taxable by the State.

Since in Texas the so-called leases were present conveyances of the oil and gas in place, then, subject to the apportionment requirement of Section 2 of Article I of the Constitution of the United States, the federal government could levy a direct tax against the lessee upon the value of the oil and gas in place. But it could not have done so

against respondent, because it owned no oil and gas in place. That belonged to the State of Oklahoma, the owner of the soil. All that respondent had was a contract with the State which gave him the right and imposed upon him the duty to explore and operate the State's land for oil and gas purposes, just as in *Jaybird Mining Co.* v. *Weir*, 271 U. S. 609, 612, this court said that, "the lessee is an agency or instrumentality employed by the government for the development and use of the restricted land and to mine ores therefrom for the benefit of its Indian wards."

The words of grant or lease in the leases construed by this court in Indian Territory Illuminating Oil Company v. Oklahoma, Howard v. Gypsy Oil Company, Large Oil Company v. Howard and Gillespie v. Oklahoma, were not different from those generally used in commercial leases of unrestricted lands in Oklahoma. And the leases executed by the Commissioners of the Land Office of Oklahoma were in fact modeled upon those prepared by the Interior Department and used in leasing the lands in the Osage Indian Reservation and in departmental leases upon lands of the Five Civilized Tribes. Those prepared by the Interior Department provided that the lessor, in consideration of $..... and of the royalties, covenants, stipulations and conditions therein contained and thereby agreed to be paid, observed and performed by the lessee, does thereby demise, grant, lease and let unto the lessee, for five years from the date of approval thereof, and as long thereafter

as oil is found in paying quantities, all the oil deposits in and under the lands described as follows:" (Mills Oklahoma Indian Land Laws, 2nd Ed., page 1037. Also, see Rules and Regulations of Interior Department governing oil leases in Osage Indian Reservation).

The leases executed by the Commissioners of the Land Office of Oklahoma provided that the lessors, in consideration of the royalties, covenants, stipulations and conditions therein expressed and agreed to be paid, observed and performed by the lessee, do thereby lease and let unto the lessee, for a term of five years from and after the date thereof, all oil deposits and natural gas in and under the following described tract of land (R. 67-8 and 74-5).

Considering the nature of an oil and gas lease in Oklahoma, all the implications of Group No. 1 Oil Corporation v. Bass are in respondent's favor. This court there said that property sold or otherwise disposed of by the government, either state or national, in order to raise revenue for governmental purposes, is a governmental instrumentality, with respect to which neither the property itself before sale nor its sale by one government may be taxed by the other. The leased land was therefore a governmental instrumentality of the State of Oklahoma. The leases, being intended "to raise revenue for governmental purposes", were governmental instrumentalities. The leasing of it by the State could not be taxed by the federal government.

No federal tax could be levied upon the leases in the hands of the lessee, because, as said in *Indian Territory Illuminating Oil Company* v. *Oklahoma,* 240 U. S. 522, a tax upon the leases is a tax upon the power to make them, and could be used to destroy the power to make them. If the leases themselves were not taxable, then the income from the leases is not taxable, for, as said in *Gillespie* v. *Oklahoma,* 257 U. S. 501, "In cases where the principal is absolutely immune from interference an inquiry is allowed into sources from which the next income is derived, and if a part of it comes from such a source, the tax is *pro tanto* void. * * * The same considerations that invalidate a tax upon the leases invalidate a tax upon the profits of the leases."

If any and every oil and gas lessee of state lands, without regard to the nature and effect of his lease under local law, is subject to taxation by the federal government upon such lease or the profits derived from it, then there was no occasion for this court in the Group No. I Oil Corporation case to inquire into the nature and legal effect of a lease in the State of Texas, or to find as the ground of its decision that in that State an oil and gas lease is a present sale to the lessee of the oil and gas in place.

Metcalf & Eddy v. Mitchell, 269 U. S. 514, is cited

Whatever cases may be ruled by that decision, the decision itself pointedly makes it certain that this one is not.

There the court said that whether Congress had power to impose the tax must be answered by ascertaining whether its effect is such as to bring it within "those decisions holding that the very nature of our constitutional system of dual sovereign governments is such as impliedly to prohibit the federal government from taxing the instrumentalities of a state government, and in a similar manner to limit the power of the states to tax the instrumentalities of the federal government." This is another statement that the right of each government to tax the instrumentalities of the other is limited "*in a similar manner.*"

We again say, therefore, that Gillespie v. Oklahoma rules this case; for Gillespie, an oil and gas lessee of the federal government, as respondent was of the State, was held to be such a governmental instrumentality of the United States as not to be taxable by the State. Indeed, in the Metcalf & Eddy case Gillespie, Choctaw, Oklahoma & Gulf R. R. Co. and Indian Territory Illuminating Oil Company are cited by the court as examples of such nontaxable instrumentalities.

Further on the court said that any taxation by one

government of "an agency created and controlled by the other exclusively to enable it to perform a governmental function (*Gillespie* v. *Oklahoma, supra*), is prohibited"; and the court also said that "when the instrumentality is of that character, the immunity extends not only to the instrumentality itself but to income derived from it", and again cited Gillespie v. Oklahoma.

Since the power of the states and the federal government to tax the instrumentalities of the other is limited "in a similar manner", it follows that, as Oklahoma could not tax Gillespie, an oil and gas lessee of Indian lands, similarly the United States cannot tax respondent, an oil and gas lessee of Oklahoma school lands.

Forbes v. Gracey, 4 Otto 762

This case is not in point. It involved the right of a state to tax a mining claim located on lands of the United States under the Acts of July 26, 1866 (14 Stat., p. 251), and of May 10, 1872 (17 Stat., p. 91), which declared the mineral lands of the United States to be free and open to exploration, occupation and purchase by citizens of the United States, under regulations prescribed by law and according to the local custom or rules of miners in the several mining districts, and which provided that the locators should "have the exclusive right of possession and enjoyment of the surface included within the lines of their locations, and of all veins, lodes and ledges throughout

their entire depth, the top or apex of which lies inside such surface lines extended downward vertically."

In Forbes v. Gracey the court said that the miner's possessory right under the statute to explore and work the mine was property which might be sold, transferred, mortgaged or inherited, *without infringing the title of the United States*, and was therefore taxable. Those statutes have also been construed in *Belk* v. *Meagher*, 104 U. S. 279; *Gwillim* v. *Donnellan*, 115 U. S. 45; *Noyes* v. *Mantle*, 127 U. S. 348; *Manuel* v. *Wulff*, 152 U. S. 505; *Black* v. *Elkhorn Mining Co.*, 163 U. S. 445; *St. Louis Mining Co.* v. *Montana Mining Co.*, 171 U. S. 650; *Elder* v. *Wood*, 208 U. S. 226, and *Irwin* v. *Wright*, 258 U. S. 219.

Under the statutes the mining claim is a valuable right, and therefore property. In the case at bar, as in the Gillespie case, the lease confers a valuable right, and is therefore property. But the relation, under those statutes, between the miner and the United States is very different from that between the United States and Gillespie and from that between respondent and the State of Oklahoma. The miner was not an agency or instrumentality of the federal government. He assumed no obligation to it. He was under no contract with it. The legislation of the United States was merely permissive. It neither required nor contemplated that the miner should pay the government any royalty upon the ore mined. He was not an

agency or instrumentality of the government in the performance of any governmental duty. As the court said in Forbes v. Gracey, "It is very true that Congress has, by statutes and by tacit consent, permitted individuals and corporations to dig out and convert to their own use the ores containing the precious metals which are found in the lands belonging to the government, *without exacting or receiving any compensation for those ores, and without requiring the miner to buy or pay for the land*", thus showing the absence of governmental interest, and the fact that the taxation of the claim did not burden or hinder the United States in the performance of any governmental function.

This is further shown in *Irwin* v. *Wright*, 258 U. S. 219, holding in effect that mining claims have always been considered *sui generis*, the court saying:

> "The basis of the mining interest is discovery and location. These give full opportunity to the locator of the claim to take out the mineral, and, since the beginning, this right and interest never has been dependent for its enjoyment on patent, and so it has been taxable. *The rule has always been different in respect to other public lands as the numerous decisions of this court cited above show.*"

Baltimore Shipbuilding Co. v. Baltimore,
195 U. S. 375

That case held only that land conveyed in fee simple by the United States to a dock company, with a provision

in the conveyance that, under certain conditions, the property should revert to the United States, was not, while owned by the dock company, exempt from taxation by the state; that the United States had no present right *in rem*, that its rights were mere conditions subsequent, and that a state tax upon the land, and if necessary, its sale subject to the condition subsequent to enforce payment thereof, the land not being inalienable, did not interfere with any function or right of property of the United States.

Gromer v. Standard Dredging Co., 224 U. S. 362

That case holds that property used by a person in performing a contract with the federal government is not, because of its use, exempt from taxation by a state or territory in which the property has its situs. Petitioner might have cited the later case of *Susquehanna Power Co.* v. *State Tax Commission*, 51 Sup. Ct. 434, not yet officially reported, holding that because appellant was a federal instrumentality, and therefore immune from taxation by the state, "it does not follow that the property appellant uses in its power project is clothed with that immunity"; that "the distinction has long been taken between a privilege or franchise granted by the government to a private corporation in order to effect some governmental purpose, and the property employed by the grantee in the exercise of the privilege, but for private business advantage," and that

"property so owned and used has uniformly been held to be subject to state taxation."

That rule is not novel (*Railroad Co.* v. *Peniston*, 18 Wall. 5). Doubtless the State could have taxed the tools and machinery of Gillespie and Indian Territory Illuminating Oil Company used in drilling their wells and such of their property used in operating the leases as were not fixtures; and that here the United States, had it elected to do so and conformed to the apportionment requirement of the constitution, could have taxed respondent's tools and machinery used in developing and operating these leases; but that is a very different thing from a tax upon the leases themselves or upon the income derived from them.

Alward v. Johnson, 282 U. S. 509

California levied a tax upon companies operating auto trucks, jitney busses and auto stages in the transportation of persons and property as common carriers over highways in the State, and declared the same to be in lieu of all other taxes upon such property of those companies. The State Supreme Court held that the tax was one upon property; and this court, accepting that construction, held, as it did in Gromer v. Standard Dredging Company and Susquehanna Power Company v. State Tax Commission, that the fact that Alward used the property in performing a contract with the United States to carry the mails, did not

exempt it from state taxation, there being no tax upon the contract. That case, of course, is not in point.

Veazie Bank v. *Feno*, 8 Wall. 533, sustained a federal tax upon the notes of state banks used for circulation, but in the opinion the court said:

> "There was nothing in the case showing that the bank sustained any relation to the state as a financial agent, or that its authority to issue notes was conferred or exercised with any special reference to other than private interests."

The court properly held that the United States had full power to tax corporations created by a state or the franchises granted them, so long as they were not acting as governmental agencies of the state. All business done by state corporations is but the exercise of some one or more of the powers, i. e., franchises, granted them in their organization, and certainly the federal government may tax them. The state may not, in creating private corporations to carry on private business, exempt them from federal taxation.

Shaw v. Gibson-Zahniser Oil Corporation, 276 U. S. 575

There the restricted allotted lands of Miller Tiger, a full blood Creek Indian minor, had been leased for oil and gas purposes. With the royalties paid under that lease Tiger's guardian, by permission of the County court, purchased for Tiger from a citizen of Oklahoma a tract of

land not restricted but subject at the time to general, state, county and municipal taxation. The Secretary of the Interior and the County court conditioned the authority for this investment of the minor's funds upon the insertion in the deed to Tiger of a provision that the purchased land "should not be alienated or leased during the lifetime of the grantee prior to April 26, 1931, without the consent and approval of the Secretary of the Interior." The purchased land was subsequently leased for oil and gas purposes, and the lease was acquired by Gibson-Zahniser Oil Corporation. The United States Indian Agency paid in behalf of the minor the ad valorem taxes on the land without objection, but Gibson-Zahniser Oil Corporation refused to pay the State's gross production tax upon its portion of the oil and gas produced, contending that this land had the same status as an original restricted allotment, and that the lessee was therefore a federal instrumentality and exempt from the State's gross production tax. The court held that the purchased lands, and the interest of the lessee in them, were not such instrumentalities of the government as would be declared immune from state taxation in the absence of an express exemption by Congress, even if Congress could exempt them, and that the act of the Secretary in imposing the restriction was not the exercise of any power which might reside in Congress to exempt them from taxation, although as to lessees of restricted allotted lands, "nothing short of an express declaration by Congress

would have subjected them to state taxation." The sum of the decision was that Congress had not purported to exempt this land from taxation, and that the Secretary of the Interior had no power to do so.

South Carolina v. United States,
199 U. S. 437

The facts in that case, the nature of the acts done by the State, the relation of the United States to those acts, and their effect upon the federal government, are entirely different from those in the case at bar.

South Carolina made no pretense of restricting and regulating the use of intoxicating liquors, but declared a state monopoly in the business of selling them for all purposes, beverage, medicinal and industrial, and prohibited sales by any person except the State's dispensers. Because the business was carried on by the State through its dispensers, it contended that the United States could not require of the latter payment of the license or excise tax levied by act of Congress upon those who sold liquor. This court held that it could.

The rationale of the decision is: (a) That the constitution must be interpreted in the light of the common law, the principles and history of which were familiar to its framers. (b) As to excises, the power granted by the constitution to the United States to lay and collect them

is limited only by the provision that they must be for public purposes and must be uniform throughout the United States. (c) At the time of the adoption of the constitution, it was contemplated that the United States would lay and collect excises upon the sellers of intoxicants; also, under the common law, in the light of which the constitution must be interpreted, monopolies were odious, all the avenues of trade were open to the individual, and the possibility of a state's entering that business in a commercial way and monopolizing it was never contemplated. (d) If a state could enter and monopolize that business, and thus exempt its dispensers from payment of the tax, contrary to the intention and expectation of the framers of the constitution, it could monopolize all other avenues of trade, and dry up the sources of federal revenue; and a state's engaging in and monopolizing that business commercially was not the exercise of a proper governmental function within the contemplation of the constitution interpreted in the light of the common law. In short, the decision was put upon the ground that South Carolina could not thus "destroy a pre-existing right of taxation possessed by the government of the United States" (*Murray* v. *Wilson Distillery Co.*, 213 U. S. 151, 173).

The case involved no question of a state's power to own, hold and use its public lands for the accomplishment of a governmental purpose. Many of the states owned large

bodies of public lands at the time of the adoption of the constitution. It involved no question of the power of sovereignty to develop its mineral lands for mineral purposes. South Carolina was not carrying out the terms of a compact between it and the United States which obligated it to do the thing that it was doing.

Here, Oklahoma, in leasing these lands, was executing the terms of a governmental trust. If, instead of leasing only its school lands in conformity with the Enabling Act, it should engage in the oil business generally, for that purpose acquire or take leases upon lands not belonging to it, and should carry on the business, not as a governmental function, the execution of a governmental trust under its compact with the United States, but generally and commercially, and especially if it should undertake to monopolize the business, then doubtless it would fall within this decision, and its agents and instrumentalities for so doing would be taxable. But that is not the case. It has dealt only with its own lands, granted to it by the United States for that purpose, and the leases are a means of accomplishing that purpose.

In the South Carolina case the court also said that the tax was not imposed on any property belonging to the State. Here, the tax ultimately is a tax upon the property of the State. A tax upon the income of the State's lessee is a tax upon the lease, and a tax upon the lease is a tax upon the power of the State to execute it.

II.

Petitioner's contention that, if for any purpose respondent was an agency of the State, it was not exempt from the tax imposed upon income derived from the exercise of non-governmental functions.

We have endeavored to show that these were governmental lands granted and held for governmental purposes, the leasing of which to obtain revenue for those purposes was expressly made a governmental function. If those facts are true, then the lease was a governmental instrumentality and respondent a governmental agency, and its income earned and received in performing this governmental duty in the State's behalf was not derived "from the exercise of non-governmental functions."

The argument that, as lessee of these lands respondent was engaged in producing oil for itself as well as the State, and that, as to its share of the product, it was engaged like any other producer in conducting a business enterprise for private profit, was urged in the Gillespie case, was equally applicable there, and was not availing.

In this connection petitioner quotes from *Clallam County* v. *United States*, 263 U. S. 341, that, "This is not like the case of a corporation having its own purposes as well as those of the United States and interested in profit on its own account" as implying that in this case, if respondent had its own purposes as well as those of the State, and was interested in profit on its own account, its income

from its State leases would be taxable; but the quotation is misapplied. It was not made in relation to the right of Clallam County to tax the income of the Spruce Corporation or a contract between it and the United States, but only the physical property of the Spruce Corporation situated within the county, on the principle of *Railroad Company* v. *Peniston,* 18 Wall. 5, and *Gromer* v. *Standard Dredging Company,* 224 U. S. 362, that property used in doing work or performing a contract for the United States is not, merely because of its use, exempt from state taxation. But this court said that, as the Spruce Corporation was organized by the United States as an instrumentality for carrying on the war, and as all its property was conveyed to it by or bought with money of the United States and was used by it solely as a means to that end, the property was not only used in doing work for the United States but in effect belonged to the United States, and that the corporation had no private purposes to serve, and the quoted statement was made as distinguishing that case from those to which Railroad Company v. Peniston and Gromer v. Standard Dredging Company were applicable. If the United States were attempting to tax respondent's tools and machinery used in developing and operating its lease, then the quotation would be in point; but it has no application when the attempt is to tax the income from a governmental lease, which is a tax on the lease itself and a tax on the power of the State to execute it.

III.

Petitioner's contention that Gillespie v. Oklahoma, 257 U. S. 501, is not controlling.

It is said that that decision is predicated upon the peculiar and anomalous relationship existing between the United States and its Indian wards, and particularly upon the duties and obligations of the federal government as a trustee for the Indians of restricted Indian lands.

The basis of the decision, however, is the governmental power of the United States over the Indians and their lands, and the fact that Gillespie was an agency for carrying into execution certain of those powers. The decision was predicated upon the existence of the power, not upon its source or origin. It is immaterial whether the governmental power of the United States over the Indians and their lands is to be deduced from the power to regulate commerce with the Indian tribes, or to make all needful rules and regulations respecting the territory or other property of the United States, or is implied from the presence of the Indians as semi-organized communities within the territorial jurisdiction of the United States. Whatever the source of the power, it is still a governmental power, and its exercise is the performance of a governmental function. In no respect does it transcend the power of the United States to issue bonds or to exercise any other of its undoubted powers. The execution of the power is protected from

state interference, not because of some peculiar relation between the United States and the Indians which gives rise to the power, but because it is an undoubted governmental power no more to be obstructed or interfered with by the State than is the exercise of any other governmental power of the United States.

The principle which ruled Gillespie v. Oklahoma was stated by the court in terms of general application, as follows:

> "A tax upon the leases is a tax upon the power to make them, and could be used to destroy the power to make them. The step from this to the invalidity of the tax upon income from the leases is not long. In cases where the principal is absolutely immune from interference, an inquiry is allowed into the source from which net income is derived, and if a part of it comes from such a source, the tax is *pro tanto* void."

And, in support of that declaration of the controlling principle, the court cited *Pollock* v. *Farmers Loan & Trust Co.*, 157 U. S. 429, 158 U. S. 601; *Evans* v. *Gore*, 253 U. S. 245, and *Oahu Ry. & Land Co.* v. *Pratt*, 14 Hawaii 126; none of them Indian cases.

The United States has the same governmental power of legislation over the Indians and their lands that it has over the territories of the United States, explained in *National Bank* v. *County of Yankton*, 101 U. S. 129, 133, which equally may not be interfered with by the states by taxation or otherwise (*Farmers & Mechanics Savings Bank* v. *Minnesota*, 232 U. S. 516).

No useful purpose can be served by elaborating upon the facts that no Indian tribe within the United States has ever been recognized as an independent nation (*Cherokee Nation* v. *Georgia*, 5 Pet. 16; *United States* v. *Kagama*, 118 U. S. 375); that their status has always been that of dependent political communities, and that both they and their lands have always been subject to laws enacted by Congress without their consent (*Stephens* v. *Cherokee Nation*, 174 U. S. 445; *Cherokee Nation* v. *Hitchcock*, 187 U. S. 294; *Lone Wolf* v. *Hitchcock*, 187 U. S. 553; *United States* v. *Kagama*, *supra*); that so-called treaties with them have been mere acts of Congress, "looked upon not as contracts, but as public laws which could be abrogated at the will of the United States" (*Choate* v. *Trapp*, 224 U. S. 665); that the Indian Appropriation Act of March 3, 1871 (16 Stat. 544, 566), provided that no Indian tribe should be recognized as a nation with which the United States might contract by treaty; and that in *Stephens* v. *Cherokee Nation*, *Cherokee Nation* v. *Hitchcock* and *Lone Wolf* v. *Hitchcock*, *supra*, it was held that legislation in direct violation of so-called treaties was valid.

We perceive no difference in purpose and function between the lease in this case and that in the Gillespie case. In each case the lease was a governmental instrumentality and the lessee a governmental agency for the performance of a governmental function. If the fact that the federal government was a trustee for the Indians of their re-

stricted lands is significant beyond giving rise to the governmental power or calling it into play, then it is also a fact that the State, with the assent and participation of the federal government, became and was a trustee for its wards, its children, of these governmental lands. The Enabling Act and the Oklahoma constitution created a governmental trust as to them, and the State pledged its faith to preserve them as a "sacred trust" for the purposes for which they were granted.

The title to the lands was granted to the State in fee simple; but they were granted for the use and benefit of the common schools, to serve a governmental purpose, and the State contracted with the United States to so keep and use them. This constituted a governmental trust. There was no reservation in the Enabling Act of right on the part of the United States to tax these lands or the State's power to lease them in executing this governmental trust. And such a right, inconsistent with the grant and the purpose of the grant, with the relation between the states and the United States, and with the plan and purpose of the Union, and derogatory to the dignity and sovereignty of the State and to its supremacy in its sphere, cannot rest upon implication. On the other hand, the fact that the lands were granted to the State by the United States for the very governmental purpose to which they are being put, and that the grant specifically provided that the State should not sell but might lease them in execution of the

trust, negatives the existence of any intention, right or power on the part of the United States to tax the land or the development and operation thereof. The grant for the purpose specified in the Enabling Act, specifically accepted in the State constitution, constitutes an inviolable contract or compact between the United States and the State; and for the United States to tax the land, the leases thereon executed in conformity with the contract or the income therefrom, tends to frustrate the governmental purpose aimed at, hinders the State in carrying out that purpose, lessens the value of the grant, burdens the exercise by the State of the governmental trust thus created and assumed, and violates the compact.

We think there is no weight in petitioner's argument that, in the Gillespie case, it was *agreed* that Gillespie was an instrumentality of the United States in carrying out its duties to the Indians, whereas petitioner makes no similar concession in this case. That Gillespie was such instrumentality is undoubted. The fact had already been determined in the cases of Choctaw, Oklahoma & Gulf R. R. Co. v. Harrison and Indian Territory Illuminating Oil Co. v. Oklahoma. The decision in the Gillespie case would not have been different had the State made an issue upon that question. Also, that the lessee was such instrumentality was expressly ruled in the Jaybird Mining Company's case.

Petitioner says that he sees no difference in substance between respondent and Group No. 1 Oil Corporation. In

that company's case, however, this court clearly pointed out the distinction between Group No. 1 Oil Corporation and Gillespie, and said in effect that if Gillespie had purchased the oil and gas in place as did Group No. 1 Oil Corporation, he would have been taxable by the State. As Group No. 1 Oil Corporation bought from the State of Texas the oil and gas in and under the land, and owned it at all times thereafter, while respondent did not and could not buy the oil and gas in place, but was only an agency of the State for the development and operation of this governmental land in the execution of this governmental trust, the difference between that case and this is that existing between an owner mining his own mineral for his own account and a governmental lessee performing a governmental function for the State. And, as already pointed out, Group No. 1 Oil Corporation could have been taxed by the federal government, under proper apportionment, upon the value of the oil and gas in place. Respondent could not, for it owned no oil and gas in place.

The decision of the court below should be affirmed.

Respectfully submitted,

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January, 1932.

APPENDIX A

(Applicable Portion of Section 8 of Enabling Act, 34 Stat. 273)

Where any part of the lands granted by this Act to the State of Oklahoma are valuable for minerals, gas and oil, such lands shall not be sold by the said State prior to January first, nineteen hundred and fifteen; but the same may be leased for periods not exceeding five years by the State officers duly authorized for that purpose, such leasing to be made by public competition after not less than thirty days' advertisement in the manner to be prescribed by law, and all such leasing shall be done under sealed bids and awarded to the highest responsible bidder. The leasing shall require and the advertisement shall specify in each case a fixed royalty to be paid by the successful bidder, in addition to any bonus offered for the lease, and all proceeds from leases shall be covered into the fund to which that shall properly belong, and no transfer or assignment of any lease shall be valid or confer any right in the assignee without the consent of the proper State authorities in writing: Provided, however, That agricultural lessees in possession of such lands shall be reimbursed by the mining lessees for all damage done to said agricultural lessees' interest therein by reason of such mining operations. The Legislature of the State may prescribe additional legislation governing such leases not in conflict herewith.

(Section 9 of Enabling Act, 34 Stat. 274)

That said sections sixteen and thirty-six, and lands taken in lieu thereof, herein granted for the support of the common schools, if sold, may be appraised and sold at public sale in one hundred and sixty-acre tracts or less, under such rules and regulations as the Legislature of the said State may prescribe, preference right to purchase at the highest bid being given to the lessee at the time of such sale, the proceeds to constitute a permanent school fund the interest of which only shall be expended in the support

of such schools. But said lands may, under such regulations as the Legislature may prescribe, be leased for periods not to exceed ten years; and such lands shall not be subject to homestead entry or any other entry under the land laws of the United States, whether surveyed or unsurveyed, but shall be reserved for school purposes only.

APPENDIX B

(Section 1 of Article XI of Oklahoma Constitution)

The State hereby accepts all grants of land and donations of money made by the United States under the provisions of the Enabling Act, and any other Acts of Congress, for the uses and purposes and upon the conditions, and under the limitations for which the same are granted or donated; and the faith of the State is hereby pledged to preserve such lands and moneys and all moneys derived from the sale of any of said lands as a sacred trust, and to keep the same for the uses and purposes for which they were granted or donated.

APPENDIX C

(Ordinance Accepting Enabling Act)

Be It Ordained by the Constitutional Convention for the proposed State of Oklahoma, that said Constitutional Convention do, by this ordinance irrevocable, accept the terms and conditions of an Act of Congress of the United States, entitled, "An Act to Enable the People of Oklahoma and the Indian Territory to form a Constitution and State Government and be admitted into the Union on an equal footing with the original states; and to Enable the People of New Mexico and Arizona to form a Constitution and State Government and be admitted into the Union on an equal footing with the original states," approved June the sixteenth, *Anno Domini,* Nineteen Hundred and Six.

(Section 1 of Article VI of the Oklahoma Constitution)

The Executive authority of the State shall be vested in a Governor, Lieutenant Governor, Secretary of State, State Auditor, Attorney General, State Treasurer, Superintendent of Public Instruction, State Examiner and Inspector, Chief Mine Inspector, Commissioner of Labor, Commissioner of Charities and Corrections, Commissioner of Insurance, and other officers provided by law and this Constitution, each of whom shall keep his office and public records, books, and papers at the seat of government, and shall perform such duties as may be designated in this Constitution or prescribed by law.

(Section 2 of Article XVII of the Oklahoma Constitution)

There are hereby created, subject to change by the Legislature, in and for each organized county of this State, the offices of judge of the County Court, County Attorney, Clerk of the District Court, County Clerk, Sheriff, County Treasurer, Register of Deeds, County Surveyor, *Superintendent of Public Instruction,* three County Commissioners, and such municipal township officers as are now provided for under the laws of the Territory of Oklahoma, except as in this Constitution otherwise provided.

(Sections 1, 4 and 5 of Article XIII of the Oklahoma Constitution)

Section 1. The Legislature shall establish and maintain a system of free public schools wherein all the children of the State may be educated.

Sec. 4. The Legislature shall provide for the compulsory attendance at some public or other school, unless other means of education are provided, of all the children in the State who are sound in mind and body, between the ages of eight and sixteen years, for at least three months in each year.

Sec. 5. The supervision of instruction in the public schools shall be vested in a Board of Education, whose powers and duties shall be prescribed by law. The Superintendent of Public Instruction shall be President of the Board. Until otherwise provided by law, the Governor, Secretary of State, and Attorney General shall be ex-officio members, and with the Superintendent, compose said Board of Education.

APPENDIX D

(Sections 2 and 3 of Article XI of the Oklahoma Constitution)

Sec. 2. All proceeds of the sale of public lands that have heretofore been or may be hereafter given by the United States for the use and benefit of the common schools of this State, all such per centum as may be granted by the United States on the sales of public lands, the sum of five million dollars appropriated to the State for the use and benefit of the common schools in lieu of sections sixteen and thirty-six, and other lands of the Indian Territory, the proceeds of all property that shall fall to the State by escheat, the proceeds of all gifts or donations to the State for common schools not otherwise appropriated by the terms of the gifts, and such other appropriations, gifts, or donations as shall be made by the Legislature for the benefit of the common schools, shall constitute the permanent school fund, the income from which shall be used for the maintenance of the common schools in the State. The principal shall be deemed a trust fund held by the State, and shall forever remain inviolate. It may be increased, but never be diminished. The State shall reimburse said permanent school fund for all losses thereof which may in any manner occur, and no portion of said fund shall be diverted for any other use or purpose.

Sec. 3. The interest and income of the permanent school fund, the net income from the leasing of public lands

which have been or may be granted by the United States to the State for the use and benefit of the common schools, together with any revenues derived from taxes authorized to be levied for such purposes, and any other sums which may be added thereto by law, shall be used and applied each year for the benefit of the common schools of the State, and shall be, for this purpose, apportioned among and between all the several common school districts of the State in proportion to the school population of the several districts, and no part of the fund shall ever be diverted from this purpose, or used for any other purpose than the support and maintenance of common schools for the equal benefit of all the people of the State.

APPENDIX E

(Section 32 of Article VI of the Oklahoma Constitution)

The Governor, Secretary of State, State Auditor, Superintendent of Public Instruction, and the President of the Board of Agriculture, shall constitute the Commissioners of the Land Office, who shall have charge of the sale, rental, disposal, and managing of the school lands and other public lands of the State, and of the funds and proceeds derived therefrom, under rules and regulations prescribed by the Legislature.

APPENDIX F

(Sections 9415, 9417, 9418 and 9423, Compiled Oklahoma Statutes, 1921)

9415. When any tract of the school or other public lands, granted to the State of Oklahoma under the act of congress known as the "Enabling Act" is known by the commissioners of the land office of the State to contain oil or gas, or where such lands are, by said commissioners,

deemed valuable for oil and gas purposes, such commissioners shall enter of record in their office their finding, declaring that such oil or gas character exists, and further declaring that the oil and gas deposits are segregated from the surface use and interest therein, and such segregation of such deposits shall conclusively withhold the same from sale, lease or other alienation, except as provided in this article.

9417. The oil and gas interest described in this article in such lands may be leased by the commissioners of the land office for oil and gas purposes to the same extent and in the same manner as a private owner of lands in fee could, in his own right, execute a grant thereto, subject, however, to the following limitations:

First. For a period not exceeding five years, with suitable provisions for preference right to release for a second term of five years at its expiration, at the maximum rate of rentals, royalties and bonuses that may be obtained therefor, at the time of such renewal.

Second. Upon due advertisement and public notice of not less than thirty days, in such manner as the commissioners may, by rule, prescribe.

Third. Such leasing shall be done under public bids and awarded to the highest responsible bidder: Provided, that the commissioners of the land office shall have power to reject any and all bids.

9418. The lease contract of the State with any lessee for oil and gas purposes shall stipulate, and the advertisement for bids for leasing such land shall specify, a fixed royalty, to be determined by the commissioners of the land office, and in no event less than twelve and one-half per cent of the total output of such oil and gas, and in addition thereto any bonus offered for such lease, and shall also require a deposit of sufficient earnest money in the hands of the commission as the commission may require to accompany each bid, with appropriate conditions of forfeiture for failure to comply with the terms and conditions of bid-

ding upon such lands. All leases for oil and gas provided in this article shall contain a provision requiring the lessee to drill a sufficient number of wells upon the leased premises to offset the wells upon adjoining contiguous premises, and a further provision that a failure to faithfully operate the leased premises for oil and gas to as full an extent as individual and corporate premises are being operated within the general oil and gas field where such land is located, shall forfeit such lease to the State. No transfer or assignment of any lease shall be valid or convey any right in the assignee without the consent in writing of the commissioners of the land office. The board of commissioners shall require a good and sufficient bond for the faithful performance of said lease and may make such additional rules and regulations covering same as are not specifically provided for in this article.

9423. The proceeds derived in bonuses and royalties and from other inducements and considerations for the execution and operation of the oil and gas leases in this article provided, shall be carried in the several funds, for the use and benefit of which such lands were granted by the United States to the State of Oklahoma, and to the territory now comprising the area embraced within the said State, under the provisions of the enabling act, and any and all other acts of Congress, for the uses and purposes, and upon the conditions, and under the limitations for which the same were granted; and the money resulting from such lease and from the operation thereof shall be handled, disposed of and used in like manner as the other moneys belonging to said several funds under the laws of this State.

APPENDIX G

(Sections 9424 and 9430, Compiled Oklahoma Statutes)

9424. The Commissioners of the Land Office are authorized to lease for oil and gas purposes any of the school

or other lands owned by the State of Oklahoma, which such commissioners may deem valuable for oil and gas, for the term of five years and as long thereafter as oil or gas may be produced therefrom in paying quantities, upon such terms and conditions and in such quantities as the commissioners shall by rules and regulations prescribe. Each such lease shall provide for the delivery to the State of a royalty of not less than one-eighth part of the oil or gas produced from the leased premises or in lieu thereof the payment to the State of the market value of said royalty interest, as the commissioners may elect. Such leasing shall be made by public competition after not less than 30 days' notice by publication in two newspapers authorized by law to publish legal notices, one of which newspapers shall be published at the State Capitol, and the other in the county where the land is situated, such leasing shall be let by sealed bids and each lease awarded to the highest responsible bidder. Such oil and gas leases may be assigned only with the consent and approval of the Commissioners of the Land Office. Provided, that the commissioners have the right to reject any and all bids.

9425. The commissioners are empowered to segregate any of the school or public lands for mineral purposes which the commissioners may, by order entered of record, determine to be valuable for oil, gas or mineral purposes, and each agricultural, grazing or other lease of the surface rights or interest in any land so segregated shall reserve to the State, its lessees or grantees, the right to explore, drill and operate for oil or gas on such lands as well as the right to enter upon the said lands and enjoy the mining rights so reserved.

9426. All oil and gas leases executed by the Commissioners of the Land Office shall be for a term of five years and as long thereafter as oil or gas may be produced in paying quantities; provided, upon the forfeiture, or cancellation or surrender, or expiration of lease by reason of its termination on account of the five-year limit, provided for in the "Enabling Act," or any other cause, the School

Land Commissioners shall provide for the leasing of such land in the same way and in the same manner that the School Land Commissioners lease land which has never been leased: Provided, on such leases which are surrendered or which may expire or which have expired, the lessees or assigns shall have the value of the physical properties on such lease, which value shall be determined by a board of appraisers especially appointed by the School Land Commissioners for the appraising of physical property of leases. Provided, no physical property valuation shall be attached or considered in the making of a lease on a tract consisting of more than 640 acres. If no well shall be completed upon any leased premises within one year from the date of the lease, the lessee shall pay to the State of Oklahoma an annual rental in advance of such sum per acre as the commissioners shall prescribe in the lease, which payment shall operate to defer the completion of a well during the year for which such rental payment is made.

9427. All leases for oil and gas shall contain a provision to drill one well on each leased tract within one year from the date of such lease or on failure to complete such well to pay an annual rental per acre as hereinbefore provided. All such leases shall further provide that the lessee shall drill a sufficient number of wells upon the leased lands to offset all producing wells upon any adjoining or contiguous lands, and a further provision that the failure of the lessee to diligently and in good faith operate the leased premises for oil and gas to as full an extent as other lands are operated in the general oil and gas field where such leased lands is located shall forfeit all rights of the lessee under such lease. Each lessee shall execute a bond to the State of Okahoma with sureties to the approval of the commissioners and in such sum as the commissioners shall prescribe, conditioned for the faithful performance of the provisions of the lease and for the payment of all recoverable damages which such lessee may cause to the property, crops or rights of the surface lessee.

Each lease shall further provide that in the event the

State shall at any time operate a refinery for the refining of crude petroleum or the extraction of any of its products or by-products, the State shall have the preference right to purchase and take the production or output of any such oil or gas well at the prevailing market price thereof, upon the commissioners serving written notice upon the owners of any well, of the purpose and readiness of the State to take such production.

9428. The Commissioners of the Land Office may adopt and promulgate appropriate rules and regulations for carrying into effect the provisions of this act, but no restrictions or prohibitions against any bidder or prospective bidder shall be made other than as provided in this act.

9429. The lessee, under any oil or gas lease executed by the Commissioners of the Land Office shall be liable to the surface owner or lessee for all injury, damage or loss occurring to the surface interest, interest in such lands or to any building, crops or improvements, or other property, located upon or used in connection with said land.

9430. All funds arising from bonuses, royalties or rentals for oil and gas leases, shall be carried into and credited to the permanent funds for the use and purpose designated in the grant of such lands by Congress to the State of Oklahoma and all such funds shall be kept, handled and used in like manner as other moneys belonging to said permanent funds.

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In the

Supreme Court of the United States

October Term, 1931.

NUMBER 341

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

vs.

CORONADO OIL AND GAS COMPANY, RESPONDENT,

MOTION FOR LEAVE TO FILE BRIEF OF AMICUS CURIAE.

May It Please the Court:

The undersigned, Attorney General of the State of Oklahoma, respectfully moves this Honorable Court for leave to file on behalf of the State of Oklahoma the accompanying brief in this case as *amicus curiae*.

J. BERRY KING,
Attorney General of the State of Oklahoma.

F. M. DUDLEY,
Assistant Attorney General.

Subscribed and sworn to before me, a Notary Public, this 9th day of January, 1932.

EDNA CLARY,

(Seal) Notary Public

My commission expires September 8, 1934.

IN THE

Supreme Court of the United States

October Term, 1931.

Number 341.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

vs.

CORONADO OIL AND GAS COMPANY, RESPONDENT.

On Writ of Certiorari to the Court of Appeals of the District of Columbia.

BRIEF OF STATE OF OKLAHOMA AS AMICUS CURIAE.

Opinions Below.

The opinion of the United States Board of Tax Appeals (R. 24-52) is reported in 14 B. T. A. 1214. The opinion of the Court of Appeals of the District of Columbia (R. 96-102) is reported in 50 Fed. (2d) 998.

Jurisdiction.

The judgment of the Court of Appeals was entered

June 1, 1931 (R. 102). The petition for the writ of certiorari was filed September 1, 1931, and was granted October 26, 1931 (R. 103). The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

Question Presented.

Is the income derived from the operation by the lessee of an oil and gas lease upon the common school lands of the State subject to income taxes of the Federal government?

Statutes Involved.

The statutes involved are set forth in the Appendix, page 17, *infra*.

Statement.

As a condition of admission into the Union, Oklahoma, under the Enabling Act, was required by Congress to make provision in its Constitution for a system of common schools, and for the support and benefit of such system of schools granted to the State certain lands, with the proviso that such of said lands as were valuable for minerals should not be sold, but might be leased for periods of five (5) years, the proceeds to be paid to the permanent school fund (R. 26). Act of June 16, 1906, Sections 3, 7, 8, 9 and 22, c. 3335, 34 Stat. 267, pp. 17-19, *infra*. Oklahoma accepted the grant of school lands, and in compliance with the provisions of the Enabling Act provided in its Consti-

tution for a common school system and pledged its faith to preserve the lands and moneys derived therefrom as a "sacred trust" and to keep the same for the uses and purposes for which they were granted; and created a Commission in the executive branch of State government charged with the sale, rental, disposal and management of said school lands and of the funds and proceeds derived therefrom under rules and regulations prescribed by the Legislature. Section 32, Article 6; Sections 1, 2 3, Article 11; Sections 1, 4 and 5, Article 13, and Section 2, Art. 17, Constitution of Oklahoma, pp. 19-21, *infra*. Legislative provision was made for leasing the lands containing oil and gas and for the payment of the proceeds into the permanent school fund. Sections 9401, 9415-9423, 9424-9430, Compiled Oklahoma Statutes of 1921, pp. 21-28, *infra*.

Certain of the granted lands were leased by the State of Oklahoma to respondent in January, 1914 (R. 27). Said lease was renewed in March, 1919 (R. 34, 59-95).

The Commissioner of Internal Revenue assessed taxes upon respondent's net income derived from the sale of oil and gas produced from the leased lands during 1917, 1918 and 1919 (R. 25). The Board of Tax Appeals sustained the action of the Commissioner (R. 50; 14 B. T. A. 1214). The Court of Appeals of the District of Columbia reversed the decision of the Board.

The Interest of the State of Oklahoma

is to obtain the largest possible bonus, rental and royalty on every lease for oil and gas purposes covering school lands of the State. A bidder for a lease, if he be definitely assured that income derived from the sale of oil and gas produced under a State school land lease will not be subject to the Federal income tax, will offer a larger bonus, higher rentals, and a greater royalty. The State, in discharging the obligations devolved upon it with respect to the sale, rental, disposal and management of the school lands of the State and preservation of the money derived therefrom for the benefit of its common school system, is in duty bound to obtain by the use of every legitimate effort and means in leasing said lands for oil and gas purposes the greatest bonus, highest rentals, and largest royalty possible. The State desires as its primary purpose to obtain the greatest return possible from leases of its school lands—not the enrichment of its lessees. If the United States may tax the net income of a lessee derived from the sale of oil and gas produced under lease covering State school lands, such tax upon such income will constitute a direct hamper upon the efforts of the State to make the best terms for its wards—the children of the public schools of the State.

The extent to which oil and gas exist in the State school lands is, of course, problematical. The Commis-

sioners of the Land Office have furnished us with the following data: There are approximately 650,000 acres of State school land of some prospective oil and gas value, not leased at this time. During the past five years leases for oil and gas purposes on school lands have been executed as follows: 1926, 287 leases, covering 83,128 acres; 1927, 131 leases, covering 28,517 acres; 1928, 167 leases, covering 29,591 acres; 1929, 137 leases, covering 16,029 acres, and 1930, 198 leases, covering 41,369 acres. In view of the foregoing data we believe it justifiable to assert that the State is continually leasing school lands for oil and gas purposes, and such will be the case for many years to come.

Point Argued.

Gillespie v. *Oklahoma,* 257 U. S. 501, controls the instant case.

BRIEF AND ARGUMENT.

Gillespie v. *State of Oklahoma,* 257 U. S. 501, dealt with the right of the State to levy and collect a State income tax upon the net income of persons derived from the operation of leases on restricted lands. The Court in the first syllabus held:

> "The net income derived by a lessee from sales of his share of oil and gas received under leases of restricted Creek and Osage lands, which constitute him in effect *an instrumentality used by the United States in fulfilling its duties to the Indians,* can not

be taxed by a State. P. 504. *Choctaw, Oklahoma & Gulf, R. R. Co.* v. *Harrison*, 235 U. S. 292; *Indian Territory Illuminating Oil Co.* v. *Oklahoma*, 240 U. S. 522."

At page 505 in the opinion the Court said:

"In cases where the principal is absolutely immune from interference an inquiry is allowed into the sources from which net income is derived and if a part of it comes from such a source the tax is *pro tanto* void; *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, 158 U. S. 601; a rule lately illustrated by *Evans* v. *Gore*, 253 U. S. 245; and applied in a case somewhat like the present by the Supreme Court of Hawaii, *Oahu Ry. & Land Co.* v. *Pratt*, 14 Hawaii 126. * * * ."

And at page 504 in the opinion the Court reviewed prior authorities as follows:

"In *Choctaw, Oklahoma & Gulf R. R. Co.* v. *Harrison*, 235 U. S. 292, it was held that such a lessee could not be taxed on the gross sales of coals from Choctaw and Chickasaw mines, when the tax was in addition to the taxes collected upon an ad valorem basis. In *Indian Territory Illuminating Oil Co.* v. *Oklahoma*, 240 U. S. 522, it was held that a similar lessee could not be taxed upon the value of an Osage oil lease. Subsequently, the principle was applied *per curiam* to gross production taxed under a later statute of 1916, without reference to the fact that the taxes, instead of being in addition to, were in lieu of all taxes upon property rights. *Howard* v. *Gypsy Oil Co.*, 247 U. S. 503; *Large Oil Co.* v. *Howard*, 248 U. S. 549."

In *Jaybird Mining Co.* v. *Weir*, 271 U. S. 609, 612, 613, the mining company had a lease on restricted Indian land

on terms which provided for the payment of royalties on a percentage of the gross proceeds derived from the sale of ores mined. The local taxing authorities undertook to tax ad valorem lead and zinc ores mined by the company in 1920, and which were in its bins on the land January 1, 1921. In disposing of the case the Court held:

> "The Quapaw Indians are under the guardianship of the United States. The land and Indian owners are bound by restrictions specified in the patent and the acts referred to. It is the duty and established policy of the government to protect these dependents in respect to their property. The restrictions imposed are in furtherance of that policy. *United States* v. *Noble*, 237 U. S. 74, 59 L. ed. 844, 35 Sup. Ct. Rep. 532; *Goodrum* v. *Buffalo*, 89 C. C. A. 525, 162 Fed. 817. The lessee is an agency or instrumentality employed by the government for the development and use of the restricted land and to mine ores therefrom for the benefit of its Indian wards. *Choctaw, O. & G. R. Co.* v. *Harrison*, 235 U. S. 292, 59 L. ed. 234, 35 S. Ct. 27. It is elementary that the Federal government in all its activities is independent of state control. This rule is broadly applied. And without congressional consent no Federal agency or instrumentality can be taxed by state authority. 'With regard to taxation, no matter how reasonable, or how universal and undiscriminating, the state's inability to interfere has been regarded as established since *McCulloch* v. *Maryland*, 4 Wheat. 316, 4 L. ed. 579.' *Johnson* v. *Maryland*, 254 U. S. 51, 55, 65 L. ed. 126, 128, 41 Sup. Ct. Rep. 16. And see *Farmers' & M. Bank* v. *Minnesota*, 232 U. S. 516, 58 L. ed. 706, 34 Sup. Ct. Rep. 354; *Choctaw, O. & G. R. Co.* v. *Harrison, supra; Gillespie* v. *Oklahoma*, 257 U. S. 501, 505, 66 L. ed. 338, 340, 42 Sup. Ct. Rep. 171."

In *Indian Territory Illuminating Oil Co.* v. *The State of Oklahoma,* 240 U. S. 522, the Court held:

> "A tax upon a lease made is a tax upon the power to make the lease. Leases that cannot be taxed as an entity cannot be taxed vicariously by taxing the stock of the corporation owning them where the only value of the stock is the value of the leases.
>
> "Oil leases of land in Oklahoma made by the Osage tribe of Indians under authority of the Acts of February 28, 1891, and March 3, 1905, are under the protection of the Federal government, and the lessee is a Federal instrumentality, and the State cannot, therefore, tax its interest in the leases either directly, or as the leases are represented by the capital stock of the corporation owning them. *Choctaw & Gulf R. R.* v. *Harrison,* 235 U. S. 292."

In the above cited cases the United States through agents and instrumentalities was carrying out duties and policies which it had assumed as guardian to its Indian wards, and denied the State in *Gillespie* v. *State, supra,* the privilege of taxing profits of the leases, and said:

> "* * * A tax upon such profits is a direct hamper upon the efforts of the United States to make the best terms that it can for its wards."

The source of the authority and the sovereignty of the United States over the Indians is stated in Mills' Oklahoma Indian Land Laws (2d ed.), Chapter 1, Section 5, as follows:

> "Such authority of the general government does not emanate from any particular section of the Constitution and is not derived from the provision granting it 'power to regulate commerce with foreign na-

tions, and among the several States and with the Indian tribes.' It is much broader than that. It is an inherent one, arising from its political relations with those dependent people. This sovereignty of the government is exercised through Congress as the instrument established by the Constitution for the expression of its legislative will. Justice Miller in *United States* v. *Kagama,* 118 U. S. 375, has outlined the source of the authority of the Federal government over the Indian tribes as follows:

" 'The power of the general government over these remnants of a race, once powerful, now weak and diminished in numbers, is necessary to their protection as well as to the safety of those among whom they dwell. It must exist in that government because it never has existed anywhere else, because the theatre of its exercise is within the geographical limits of the United States, because it has never been denied, and because it alone can enforce its law on all the tribes.'

"The tribes were declared by Chief Justice Marshall in *Cherokee Nation* v. *Georgia,* 5 Pet. 9, to be in a 'state of pupilage,' and their relation to the United States to be that of a ward to his guardian. Such designation has been generally adopted by the courts as expressive of the authority of the United States over the Indian tribes, who are usually referred to as 'wards of the Nation,' 'pupils,' 'local dependent communities.' "

The establishment and maintenance of a system of public schools, State colleges and universities by the State of Oklahoma in conformity to its Constitution and its laws are essential governmental functions. *School District* v. *Zediker,* 4 Okla. 599, 603; *Board of Education* v. *State,* 26 Okla. 366, 370; *State ex rel.* v. *Ross,* 76 Okla. 11; *Consolidated School District No. 1* v. *Wright,* 128 Okla. 193;

Claybrook v. *City of Owensboro*, 23 Fed. 634; *Scown* v. *Czarnecki* (Ill.), 106 N. E. 276, 279. In *City of New Orleans* v. *Salmon Brick & Lumber Company*, 135 La. 827, 835, the court said:

> "The education of the youths of a state is one of the functions of government, and the public school system is a department of the government. Education insures domestic tranquility, provides for the common defense, promotes the general welfare, and it secures the blessings of liberty to ourselves and our posterity. It has ever been recognized as a function of government by all the states of the Union. The United States government has always granted aid and support to the public schools of the several states of the Union. • • •
>
> "Public schools, their property and their funds, are parts of the government itself, and are therefore public property. And thus it is not subject to taxation — state, parish, or municipal — or to seizure, • • • ."

The school lands of the State of Oklahoma are, by virtue of the provisions of the Oklahoma Enabling Act and the Constitution of Oklahoma, held by the State in trust for the education of the youth of the State.

Since the establishment and maintenance of a system of public schools by the State are essential governmental functions, its transactions with reference to the lands owned and devoted exclusively to school purposes and the means and instrumentalities employed by it in performing this function fall within the class which the

United States cannot tax consistently with the constitutional principle.

Dobbins v. *Commissioners of Erie County*, 16 Pet. 435, 448, 449.
Collector v. *Day*, 11 Wall. 113, 124.
Western Union Telegraph Co. v. *Texas*, 105 U. S. 460, 466.
Williams v. *City of Talladega*, 226 U. S. 404, 418-419.
Choctaw, Oklahoma & Gulf R. R. Co. v. *Harrison*, 235 U. S. 292.
Indian Territory Illuminating Oil Co. v. *State of Oklahoma*, 240 U. S. 522.
Howard v. *Gypsy Oil Co.*, 247 U. S. 503.
Large Oil Co. v. *Howard*, 248 U. S. 549.
Gillespie v. *State of Oklahoma*, 257 U. S. 501.
Jaybird Mining Co. v. *Weir*, 271 U. S. 609.
Panhandle Oil Co. v. *Mississippi, ex rel. Knox*, 277 U. S. 218.
Indian Motocycle Co. v. *United States*, 283 U. S. 570, 575.

In *The Collector* v. *Day*, 11 Wall. 113, 124, 127, the Court said:

> "The general government, and the States, although both exist within the same territorial limits, are separate and distinct sovereignties, acting separately and independently of each other, within their respective spheres. The former in its apppropriate sphere is supreme; but the States within the limits of their powers not granted, or, in the language of the tenth amendment, 'reserved', are as independent of the general government as that government within its sphere is independent of the States.
>
> * * * * * * * * * *
>
> " * * * It is admitted that there is no express provision in the Constitution that prohibits the general government from taxing the means and instrumentali-

ties of the States, nor is there any prohibiting the States from taxing the means and instrumentalities of that government. In both cases the exemption rests upon necessary implication, and is upheld by the great law of self-preservation; as any government, whose means employed in conducting its operations, if subject to the control of another and distinct government, can exist only at the mercy of that government. * * * ."

In *Indian Motocycle Co.* v. *United States*, 283 U. S. 570, 575, the Court, in holding that the Federal government could not impose and collect a manufacturer's excise tax upon the sale of motorcycles to the police department of a municipality, said:

"It is an established principle of our constitutional system of dual government that the instrumentalities, means and operations whereby the United States exercises its governmental powers are exempt from taxation by the States, and that the instrumentalities, means and operations whereby the states exert the governmental powers belonging to them are equally exempt from taxation by the United States. This principle is implied from the independence of the national and state governments within their respective spheres and from the provisions of the Constitution which look to the maintenance of the dual system. *Collector* v. *Day* (*Buffington* v. *Day*), 11 Wall. 113, 125, 127, 20 L. ed. 122, 126, 127; *Willcutts* v. *Bunn*, 282 U. S. 216, 224, 225, *ante*, 304, 306, 71 A. L. R. 1260, 51 S. Ct. 125. Where the principle applies it is not affected by the amount of the particular tax or the extent of the resulting interference, but is absolute. *McCulloch* v. *Maryland*, 4 Wheat. 316, 430, 4 L. ed. 579, 607; *United States* v. *Baltimore & Ohio Railway Company*, 17 Wall. 322, 327, 21 L. ed. 597, 599; *Johnson* v. *Maryland*, 254 U. S. 51, 55, 56, 65 L. ed. 126, 128, 129, 41 S. Ct. 16; *Gillespie* v. *Oklahoma*,

257 U. S. 501, 505, 66 L. ed. 338, 340, 42 S. Ct. 171; *Crandall* v. *Nevada*, 6 Wall. 35, 44-46, 18 L. ed. 745, 747, 748. * * * ."

Employing the language used by the Court of Appeals of the District of Columbia in disposing of this case below, 50 Fed. (2d) 998, 1001, 1002:

"We are unable to observe any difference in fact, or to perceive any distinction in principle, between the Gillespie case and that under consideration. In both there were oil lands. In the one case they were held by the Federal government for the benefit of the Indians; in the other by the State for the benefit of its school children, white and Indian. In each there was a lease on a royalty basis; in each the lessee was a corporation or private person; and in each the tax imposed sought to reach alone its or his profits from the operation of the lease. It is obvious, therefore, that the only difference in the facts is that in the one case the person sought to be taxed was an instrumentality of the Federal government, and in the other the State government. If the tax was invalid in the one, it seems to us it must be invalid in the other, for, as we have already seen, the two governments stand upon an equality in the right of exemption of their respective instrumentalities from taxation. Unless, therefore, there is a higher and different obligation on the Federal government in the protection of the interests of the Indians than is on a State in the education of its youth, the principle as it applies to the one must, we think, apply equally to the other. There can be no doubt that the school lands held by the State of Oklahoma in trust for the education of the youth of that State are as immune from taxation by the Federal government as the lands held by the Federal government for the Indians are immune from State taxation. If, therefore, the lessee of restricted Indian lands is a governmental instrumentality, it seems to us necessarily to follow that the lessee of school lands of the State, under identical conditions,

is a governmental instrumentality, and since, as the Supreme Court said in the Gillespie case, the principle that invalidates a tax upon the leases likewise invalidates a tax upon the profits of the lessee, it must follow, we think, that the income from the leases cannot be taxed in the one case any more than in the other. * * * While it may be true that the United States has no right to transact private business, and while it may also be true that when it enters into competition with private business, as it has in the operations of the Shipping Board and the Housing Corporation, all its acts in connection therewith are of a governmental character, and while it may be equally true that a State may engage in private business, the fact is that, in the exploitation of oil lands, like those in this and the Gillespie case, both the State and Federal governments are using property earmarked with a governmental purpose, in the pursuit of a duty enjoined upon each equally to create and preserve a fund in the one case for the Indians as wards of the nation, and in the other for the school children as wards of the State. It is, we think, the purpose, rather than the thing, which controls, but, if this is not correct, then the thing, i. e., the sale of the oil, is, in the case of the Federal government, identically like that in the case of the State government, and it cannot be said that the one government can engage in what is ordinarily designated commerce and insist that because of its restricted powers it is engaged in the performance of a governmental function, and deny to a State in the same circumstances the same character, or classify its identical activity, because of its less limited powers, in a different category."

Conclusion.

The decision of the court below should be affirmed.

Respectfully submitted,

J. Berry King,
Attorney General of Oklahoma.

F. M. Dudley,
Assistant Attorney General.

APPENDIX

Revenue Act of 1916, c. 463, 39 Stat. 756:

"Sec. 10. That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized, but not including partnerships, a tax * * *

"Sec. 11. (b) There shall not be taxed under this title any income derived * * * from the exercise of any essential governmental function accruing to any State * * *."

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1065, 1077:

"Sec. 233. (a) That in the case of a corporation subject to the tax imposed by section 230 the term 'gross income' means the gross income as defined in section 213, * * *."

"Sec. 213. That for the purposes of this title * * * the term 'gross income'—

"(a) Includes gains, profits, and income derived * * * from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *."

Act of June 16, 1906, c. 3335, 34 Stat. 267:

"Sec. 3. Fifth. That provisions shall be made for the establishment and maintenance of a system of

public schools, which shall be open to all the children of said State and free from sectarian control; * * *

"Sec. 7. That upon the admission of the State into the Union, sections numbered sixteen and thirty-six, in every township in Oklahoma Territory, and all indemnity lands heretofore selected in lieu thereof, are hereby granted to the State for the use and benefit of the common schools; * * *

"There is hereby appropriated, out of any money in the Treasury not otherwise appropriated, the sum of five million dollars for the use and benefit of the common schools of said State in lieu of sections sixteen and thirty-six, and other lands of the Indian Territory. * * *

"Sec. 8. * * *

"Where any part of the lands granted by this Act to the State of Oklahoma are valuable for minerals, which terms shall also include gas and oil, such lands shall not be sold by the said State prior to January first, nineteen hundred and fifteen; but the same may be leased for periods not exceeding five years by the State officers duly authorized for that purpose, such leasing to be made by public competition after not less than thirty days' advertisement in the manner to be prescribed by law, and all such leasing shall be done under sealed bids and awarded to the highest responsible bidder. The leasing shall require and the advertisement shall specify in each case a fixed royalty to be paid by the successful bidder, in addition to any bonus offered for the lease, and all proceeds from leases shall be covered into the fund to which they shall properly belong, and no transfer or assignment of any lease shall be valid or confer any right in the assignee without the consent of the proper State authorities in writing. * * *.

"Sec. 9. That said sections sixteen and thirty-six, and lands taken in lieu thereof, herein granted for

the support of the common schools, if sold, may be appraised and sold at public sale in one hundred and sixty acre tracts or less, under such rules and regulations as the Legislature of the said State may prescribe, preference right to purchase at the highest bid being given to the lessee at the time of such sale, the proceeds to constitute a permanent school fund, the interest of which only shall be expended in the support of such schools. But said lands may, under such regulations as the Legislature may prescribe, be leased for periods not to exceed ten years; and such lands shall not be subject to homestead entry or any other entry under the land laws of the United States, whether surveyed or unsurveyed, but shall be reserved for school purposes only."

"Sec. 22. That the constitutional convention provided for herein shall, by ordinance irrevocable, accept the terms and conditions of this Act."

Constitution of Oklahoma, Section 5, Article 1:

"Provisions shall be made for the establishment and maintenance of a system of public schools, which shall be open to all the children of the State and free from sectarian control; and said schools shall always be conducted in English. Provided, that nothing herein shall preclude the teaching of other languages in said public schools. And provided, further, that this shall not be construed to prevent the establishment and maintenance of separate schools for white and colored children."

Section 32, Article 6:

"The Governor, Secretary of State, State Auditor, Superintendent of Public Instruction, and President of the Board of Agriculture, shall constitute the Commissioners of Land Office, who shall have charge of the sale, rental, disposal, and managing of the school lands and other public lands of the State, and of the

funds and proceeds derived therefrom, under rules and regulations prescribed by the Legislature."

Article 11:

"Section 1. The State hereby accepts all grants of lands and donations of money made by the United States under the provisions of the Enabling Act, and any other Acts of Congress, for the uses and purposes and upon the conditions, and under the limitations for which the same are granted or donated; and the faith of the State is hereby pledged to preserve such lands and moneys and all moneys derived from the sale of any of said lands as a sacred trust, and to keep the same for the uses and purposes for which they were granted or donated.

"Section 2. All proceeds of the sale of public lands that have heretofore been or may be hereafter given by the United States for the use and benefit of the common schools of this State, all such per centum as may be granted by the United States on the sales of public lands, the sum of five million dollars appropriated to the State for the use and benefit of the common schools in lieu of sections sixteen and thirty-six, and other lands of the Indian Territory, the proceeds of all property that shall fall to the State by escheat, the proceeds of all gifts or donations to the State for common schools not otherwise appropriated by the terms of the gifts, and such other appropriations, gifts, or donations as shall be made by the Legislature for the benefit of the common schools, shall constitute the permanent school fund, the income from which shall be used for the maintenance of the common schools in the State. The principal shall be deemed a trust fund held by the State, and shall forever remain inviolate. It may be increased, but shall never be diminished. The State shall reimburse said permanent school fund for all losses thereof which may in any manner occur, and no portion

of said fund shall be diverted for any other use or purpose.

"Sec. 3. The interest and income of the permanent school fund, the net income from the leasing of public lands which have been or may be granted by the United States to the State for the use and benefit of the common schools, together with any revenues derived from taxes authorized to be levied for such purposes, and any other sums which may be added thereto by law, shall be used and applied each year for the benefit of the common schools of the State, and shall be, for this purpose, apportioned among and between all of the several common school districts of the State in proportion to the school population of the several districts, and no part of the fund shall ever be diverted from this purpose, or used for any other purpose than the support and maintenance of common schools for the equal benefit of all the people of the State."

Article 13:

"Section 1. The Legislature shall establish and maintain a system of free public schools wherein all the children of the State may be educated."

"Section 4. The Legislature shall provide for the compulsory attendance at some public of other school, unless other means of education are provided, of all the children of the State who are sound in mind and body, between the ages of eight and sixteen years, for at least three months in each year.

"Section 5. The supervision of instruction in the public schools shall be vested in a Board of Education, whose powers and duties shall be prescribed by law. The Superintendent of Public Instruction shall be President of the Board. Until otherwise provided by law, the Governor, Secretary of State, and Attor-

ney General shall be *ex-officio* members, and with the Superintendent, compose said Board of Education."

Article 17:

"Section 2. There are hereby created, subject to change by the Legislature, in and for each organized county of this State, the office of Judge of the County Court, County Attorney, Clerk of the District Court, County Clerk, Sheriff, County Treasurer, Register of Deeds, County Surveyor, Superintendent of Public Instruction, three County Commissioners, and such municipal township officers as are now provided for under the laws of the Territory of Oklahoma, except as in this Constitution otherwise provided."

Oklahoma Compiled Statutes of 1921:

"Section 9401. The Commissioners of the Land Office may make such detailed rules and regulations governing the leasing of the public lands of this State as to them seem proper, not in conflict herewith, and for the purpose of carrying into effect the provisions of this article."

"Section 9415. When any tract of the school or other public lands, granted to the State of Oklahoma under the Act of Congress known as the 'Enabling Act', is known by the Commissioners of the Land Office of the State to contain oil or gas, or where such lands are, by said Commissioners, deemed valuable for oil and gas purposes, such Commissioners shall enter of record in their office their finding, declaring that such oil or gas character exists, and further declaring that the oil and the gas deposits are segregated from the surface use and interest therein, and such segregation of such deposits shall conclusively withhold the same from sale, lease or other alienation, except as provided in this article.

"Section 9416. Each agricultural, timber, grazing

or other lease to any surface interest in land in which the deposits are segregated, as provided in the preceding section, shall reserve to the State, its lessees or grantees the right to drill and operate oil and gas wells on such premises, and the easement, use and right of way to enter upon and fully enjoy the mining right reserved in this article.

"Section 9417. The oil and gas interest described in this article in such lands may be leased by the Commissioners of the Land Office for oil and gas purposes to the same extent and in the same manner as a private owner of land in fee could, in his own right, execute a grant thereto, subject, however, to the following limitations:

"First. For a period not exceeding five years, with suitable provisions for preference right to release for a second term of five years at its expiration, at the maximum rate of rentals, royalties and bonuses that may be obtained therefor, at the time of such renewal.

"Second. Upon due advertisement and public notice of not less than thirty days, in such manner as the Commissioners may, by rule, prescribe.

"Third. Such leasing shall be done under public bids and awarded to the highest responsible bidder: Provided, that the Commissioners of the Land Office shall have power to reject any and all bids.

"Section 9418. The lease contract of the State with any lessee for oil and gas purposes shall stipulate, and the advertisement for bids for leasing such land shall specify, a fixed royalty, to be determined by the Commissioners of the Land Office, and in no event less than twelve and one-half per cent of the total output of such oil and gas, and in addition thereto any bonus offered for such lease, and shall also require a deposit of sufficient earnest money in the hands of the Commission as the Commission may

require to accompany each bid, with appropriate conditions of forfeiture for failure to comply with the terms and conditions of bidding upon such lands. All leases for oil and gas provided in this article shall contain a provision requiring the lessee to drill a sufficient number of wells upon the leased premises to offset the wells upon adjoining contiguous premises, and a further provision that a failure to faithfully operate the leased premises for oil and gas to as full an extent as individual and corporate premises are being operated within the general oil and gas field where such land is located, shall forfeit such lease to the State. No transfer or assignment of any lease shall be valid or convey any right in the assignee without the consent in writing of the Commissioners of the Land Office. The Board of Commissioners shall require a good and sufficient bond for the faithful performance of said lease and may make such additional rules and regulations covering same as are not specifically provided for in this article."

"Section 9422. The Commissioners of the Land office shall have plenary power and authority to enter their finding of record in their office, modifying, altering or vacating any order, finding or entry, and when any tract or parcel of land shall be proven to be valueless for oil or gas purposes, or such tract of land or the oil and gas field in which the same is situated shall become impoverished and exhausted, then such Commissioners shall enter of record their finding of such non-oil and gas bearing character, or of such exhausted or valueless condition for such oil and gas purposes, and when so entered of record by such Commissioners, the oil and gas character of such land shall conclusively terminate, for the purposes of this article. Upon premises leased for oil and gas purposes, no finding or other entry of record shall be made modifying, altering or vacating any order, finding or entry previously made until notice of not less than ten days shall be given by registered mail

to the last known address of such lessee, or by posting notice in writing in a conspicuous place upon the premises vacated by such new finding, order or entry.

"Section 9423. The proceeds derived in bonuses and royalties and from other inducements and considerations for the execution and operation of the oil and gas leases in this article provided shall be carried in the several funds for the use and benefit of which such lands were granted by the United States to the State of Oklahoma, and to the territory now comprising the area embraced within the said State, under the provisions of the Enabling Act, and any and all other Acts of Congress, for the uses and purposes, and upon the conditions, and under the limitations for which the same were granted; and the money resulting from such lease and from the operation thereof shall be handled, disposed of and used in like manner as the other moneys belonging to said several funds under the laws of this State."

"Section 9424. The Commissioners of the Land Office are authorized to lease for oil and gas purposes any of the school or other land owned by the State of Oklahoma, which such Commissioners may deem valuable for oil and gas, for the term of five years and as long thereafter as oil or gas may be produced therefrom in paying quantities, upon such terms and conditions and in such quantities as the Commissioners shall by rules and regulations prescribe. Each such lease shall provide for the delivery to the State of a royalty of not less than one-eighth part of the oil or gas produced from the leased premises, or in lieu thereof the payment to the State of the market value of said royalty interest, as the Commissioners may elect. Such leasing shall be made by public competition after not less than 30 days' notice by publication in two newspapers authorized by law to publish legal notices, one of which newspapers shall be published at the State capital, and the other in the

county where the land is situated. Such leasing shall be let by sealed bids and each lease awarded to the highest responsible bidder. Such oil and gas leases may be assigned only with the consent and approval of the Commissioners of the Land Office. Provided, that the Commissioners have the right to reject any and all bids.

"Section 9425. The Commissioners are empowered to segregate any of the school or public lands for mineral purposes which the Commissioners may, by order entered of record, determine to be valuable for oil, gas or mineral purposes, and each agricultural, grazing or other lease of the surface rights or interest in any land so segregated shall reserve to the State, its lessees or grantees, the right to explore, drill and operate for oil or gas on such lands, as well as the right to enter upon the said lands and enjoy the mining rights so reserved.

"Section 9426. All oil and gas leases executed by the Commissioners of the Land Office shall be for a term of five years and as long thereafter as oil or gas may be produced in paying quantities; provided, upon the forfeiture, or cancellation or surrender, or expiration of lease by reason of its termination on account of the five year limit provided for in the 'Enabling Act', or any other cause, the School Land Commissioners shall provide for the leasing of such land in the same way and in the same manner that the School Land Commissioners lease land which has never been leased. Provided, on such leases which are surrendered or which may expire or which have expired, the lessees or assigns shall have the value of the physical properties on such lease, which value shall be determined by a board of appraisers especially appointed by the School Land Commissioners for the appraising of physical property of leases. Provided, no physical property valuation shall be attached or considered in the making of a lease on a

tract consisting of more than 640 acres. If no well shall be completed upon any leased premises within one year from the date of the lease, the lessee shall pay to the State of Oklahoma an annual rental in advance of such sum per acre as the Commissioners shall prescribe in the lease, which payment shall operate to defer the completion of a well during the year for which such rental payment is made.

"Section 9427. All leases for oil and gas shall contain a provision to drill one well on each leased tract within one year from the date of such lease, or on failure to complete such well to pay an annual rental per acre as hereinbefore provided. All such leases shall further provide that the lessee shall drill a sufficient number of wells upon the leased lands to offset all producing wells upon any adjoining or contiguous lands, and a further provision that the failure of the lessee to diligently and in good faith operate the leased premises for oil and gas to as full an extent as other lands are operated in the general oil and gas field where such leased lands is located shall forfeit all rights of the lessee under such lease. Each lessee shall execute a bond to the State of Oklahoma with sureties to the approval of the Commissioners and in such sum as the Commissioners shall prescribe, conditioned for the faithful performance of the provisions of the lease and for the payment of all recoverable damages which such lessee may cause to the property, crops or rights of the surface lessee.

"Each lease shall further provide that in the event the State shall at any time operate a refinery for the refining of crude petroleum or the extraction of any of its products or by-products, the State shall have the preference right to purchase and take the production or output of any such oil or gas well at the prevailing market price thereof, upon the Commissioners serving written notice upon the owners of

any well of the purpose and readiness of the State to take such production.

"Section 9428. The Commissioners of the Land Office may adopt and promulgate appropriate rules and regulations for carrying into effect the provisions of this Act, but no restrictions or prohibitions against any bidder or prospective bidder shall be made other than as provided in this Act."

"Section 9430. All funds arising from bonuses, royalties or rentals for oil and gas leases shall be carried into and credited to the permanent funds for the use and purposes designated in the grant of such lands by Congress to the State of Oklahoma, and all such funds shall be kept, handled and used in like manner as other moneys belonging to said permanent funds."

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CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1931

No. 341

DAVID BURNET, Commissioner of Internal Revenue,
Petitioner,

vs.

CORONADA OIL & GAS COMPANY,
Respondent.

PETITION, BRIEF AND ARGUMENT FOR RESPONDENT

OSCAR E. CARLSTROM,
Attorney General of Illinois.

SVEINBJORN JOHNSON,
Counsel for the Board of Trustees of the University of Illinois.

Amici Curiae

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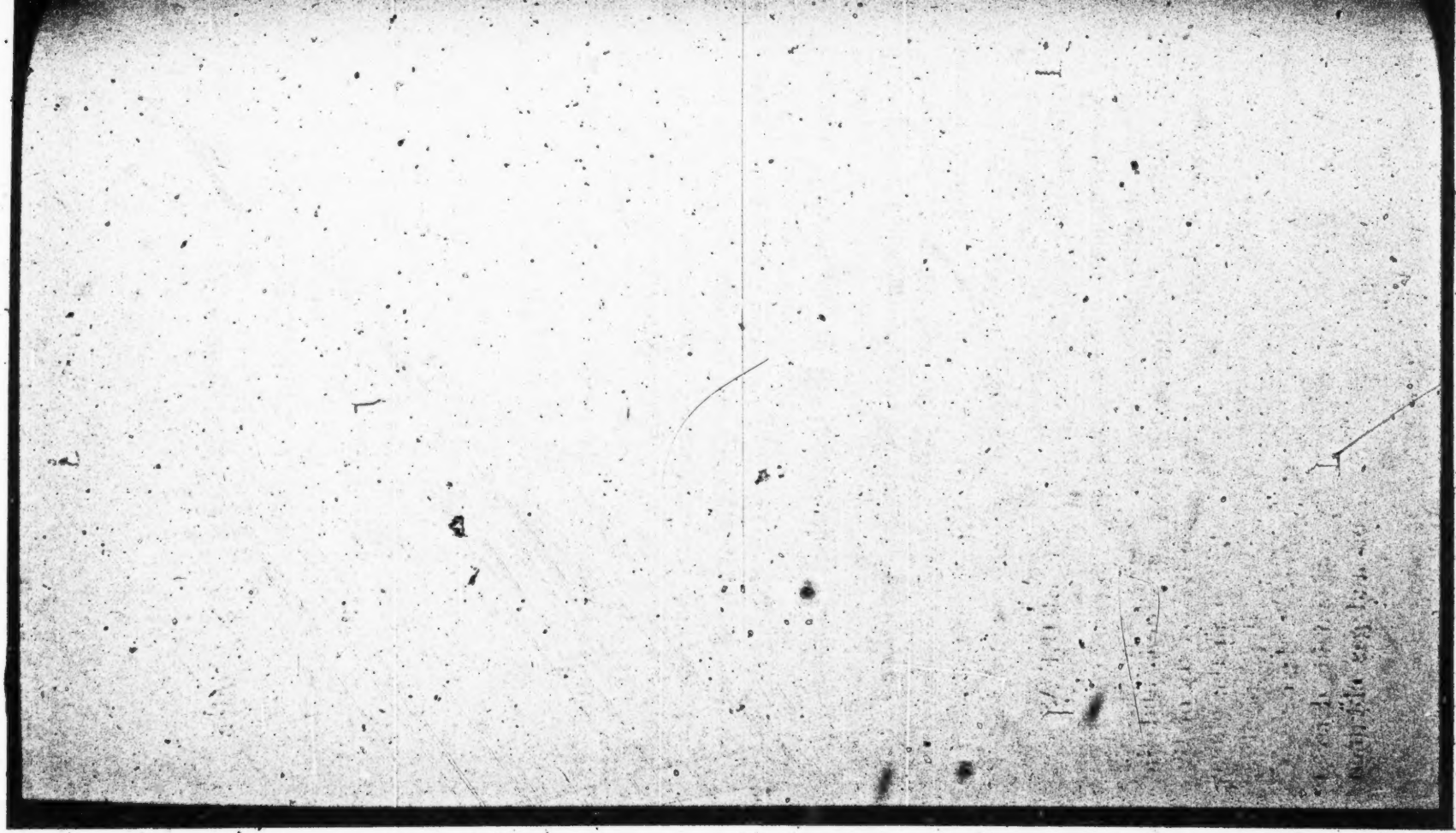

In the Supreme Court of the United States

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DAVID BURNET, Commissioner of Internal Revenue,
Petitioner,

vs.

CORONADA OIL & GAS COMPANY,
Respondent.

PETITION, BRIEF AND ARGUMENT FOR RESPONDENT

PETITION FOR LEAVE TO FILE BRIEF AS *AMICI CURIAE*

The Attorney General of the State of Illinois and the Counsel for the Board of Trustees of the University of Illinois pray for leave to file the attached brief in the above entitled cause as *amici curiae* upon one legal proposition which may become of controlling importance in the case.

Whether the net income of the respondent derived through the sale of its share of the oil and gas obtained

from school lands leased from the State of Oklahoma during the years 1917, 1918 and 1919, is taxable income, may turn upon the answer to the fundamental question whether the state, in operating and maintaining a free public school system, is engaged in performing a strictly governmental function, within the principle which exempts from the federal taxing power the property, means, instrumentalities and agencies employed by the state in its essentially governmental activities. The question whether conducting educational institutions and activities of various kinds is proprietary or governmental is of tremendous importance to every state and governmental subdivision operating schools in the United States. It is a question which is not academic at this time, but which is pending, in one form or another, before two federal tribunals, the Board of Tax Appeals and the United States Court of Customs and Patent Appeals. Every state in the Union which operates a public school, whether of elementary or of college grade, is vitally concerned over the outcome of the contest between the United States Government, on the one hand, and certain state educational institutions, on the other, over the question whether the educational activities of the states belong in the proprietary or the governmental category. If they belong in the former, the consequences are far-reaching beyond comprehension at the present moment.

We submit the appended brief in support of this petition and in behalf of the legal proposition in which we are interested.

Respectfully submitted,

OSCAR E. CARLSTROM,
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SVEINBJORN JOHNSON,
University Counsel, Board of Trustees, University of Illinois.

BRIEF OF AMICI CURIAE

The Legal Proposition

The *amici curiae* are interested in one legal proposition on which the decision of this case may turn. As we view the record, it is possible that this court may find it necessary to decide whether the State of Oklahoma, in maintaining and operating a public school system, is engaged in the performance of a strictly governmental function, within the principle which exempts from the operation of the federal taxing power the property, means, instrumentalities and agencies used by the state in its purely governmental activities.

While the Solicitor General and his associates do not explicitly contend that educational agencies are proprietary rather than governmental in character, their argument contains implications to that effect; and eminent counsel representing the United States in cases in other tribunals have urged and still urge that the public school is a proprietary institution. Marland v. United States, 53 F. (2d) 907, December, 1931, in the Court of Claims. The question is of grave importance to every state in the Union. In a case now pending in the United States Court of Customs and Patent Appeals, a dozen Attorneys General joined the State of Illinois in resisting the argument made by an Assistant Attorney General of the United States that conducting a state university was a proprietary function. The argument strikes directly at one of the few remaining, heretofore supposedly sovereign, rights of the states.

Preliminary Statement of Principles

As a groundwork for the main argument, it seems advisable to state certain principles so generally accepted that no extended reference to adjudicated cases is necessary.

I.

There is no power in the national government to tax, or impose direct burdens upon, or embarrass such instrumentalities or agencies of the states as are used in the performance of strictly governmental functions. That a like prohibition as against the states and in favor of the Federal Government exists, is equally a truism. Collector v. Day, 11 Wall. 113, 124.

II.

It has also been adjudged by the United States Supreme Court and has, indeed, become axiomatic, that this prohibition is none the less efficacious because implicit, rather than expressly stated, in the federal Constitution; for that which is implied is as much a part of the instrument as that which is expressed. South Carolina v. United States, 199 U. S. 437; Collector v. Day, supra; Clallam Co. v. United States Spruce Corporation, 263 U. S. 344.

III.

No grant of power in one part, notwithstanding it may be characterized judicially as paramount, can be exerted in violation of any fundamental right secured by other parts of the national Constitution. That is to say, no grant of power can be implied from the existence of another power, if the result of such implication be to destroy a right otherwise expressly or impliedly secured in the instrument. Adair v. United States, 208 U. S. 161, 180.

IV.

Inasmuch as there is an implied prohibition against action by the national government which tends to embarrass, burden or destroy the governmental agencies or instrumentalities of the states, a power to burden, tax, embarrass or destroy them cannot be implied from the specific grant of any

power. Any other conclusion would lead to inconsistency and the mutual cancellation of conceded powers and restrictions. The independence of the states, within their legitimate spheres of action, and the independence of the national government, in the exercise of the powers conferred upon it by the constitution, are basic concepts upon which the structure of the national government is in part rested and without which dual sovereignty in fact would be non-existent.

V.

The taxing power of the national government, in so far as there has been a grant of such power, is without limit; it may be exercised in such a manner as to "embarrass and destroy" the subject-matter of the tax, and the courts are powerless to give redress for that reason alone. Austin v. Alderman, 7 Wall. 694. This grant of power, nevertheless, like every other power granted the national government under the Constitution, is subject to the implied limit stated, namely, that it shall not be exercised so as directly to burden, embarrass, or destroy the governmental agencies or instrumentalities of the states. "The immunity is derived from the Constitution in the same sense and upon the same principle that it would be if expressed in so many words." Callam Co. v. United States Spruce Corporation, supra.

VI.

If the Oklahoma school system is, in the aggregate, an instrumentality of the State created for the more effective execution of a strictly governmental function (of providing the means of general education for the people of the state), then all property, and income of property, used for the purpose of carrying on schools is beyond the direct, as distinguished from remote and incidental, exertion of the federal taxing power, to any extent or in any degree.

These principles have often been affirmed, and, beyond a few landmarks in constitutional law, it is unnecessary to cite authorities. McCulloch v. Maryland, 4 Wheat. 316; Gibbons v. Ogden, 9 Wheat. 1; Texas v. White, 7 Wall. 700, 725; Collector v. Day, supra; United States v. Railroad Co., 17 Wall. 322; Veazie Bank v. Fenno, 8 Wall. 533; Railroad Co. v. Peniston, 18 Wall. 5; Panhandle Oil Co. v. Knox, 277 U. S. 218; Indian Motocycle Co. v. United States, 283 U. S. 570, 51 S. Ct. 601 (1931).

ARGUMENT

A

The Nature and Status of School Corporations

There is an important legal and historical distinction between state agencies engaged in educational work—the public school corporation—and the municipal corporation, proper. In the law the former have generally been regarded merely as administrative conveniences created by the state for the sole purpose of carrying on a governmental activity, and without any of the *corporate*, or proprietary, powers which historically, in Anglo-Saxon jurisprudence, have always belonged to the municipal corporation; the latter, on the other hand, in addition to its *strictly governmental* powers, has had, from the earliest times, extensive proprietary rights, with which came the capacity to sue and the liability to suit. Although the city has remained an agent of the state and subject to its control in certain strictly governmental particulars, its *corporate powers* have steadily expanded.

This expansion into "private business," to borrow a phrase from the United States Supreme Court, has not taken place in the case of the agencies or public corporations which the state has created for the purpose of operating its educational system. Whereas cities and villages are generally endowed with the power to furnish light, water and various other *proprietary* services to their citizens, public corporations of the class of school districts and universities have never been endowed with such or with analogous proprietary capacities. While they may and do hold title to property, they hold it in trust for the public and subject to the plenary control of the state legislature. The latter have been created and maintained for the sole and special purpose of carrying out a state

policy concerning education. From the standpoint of power and functions, these school corporations, proper, approximate more closely the county and the township, which, ordinarily, are not endowed with proprietary powers, save in the most limited degree.

Higher Education

The instrumentalities which the states have created for the purpose of operating universities, or institutions in which higher education is imparted, have generally been held to be public corporations, mere *instrumentalities* or *departments* of the state itself, created for greater convenience in exerting the state's sovereign power over the general field of education.

State v. Chase, 175 Minn. 259, 220 N. W. 951;
Regents v. Board, 4 Mich. 212, 227;
Regents v. Detroit, 13 Mich. 163;
Auditor v. Regents, 83 Mich. 467, 468;
47 N. W. 440, 10 L. R. A. 376;
Weinberg v. Regents, 97 Mich. 246;
Kansas v. Board of Regents, 29 L. R. A. 378, note 380;
Oklahoma v. Willis, 6 Okla., 593, 52 P. 921;
Neil v. Board, etc., 31 Ohio St. 15;
Davis v. Board, etc., 67 Cal. App. 693, 227 P. 243;
Regents v. McConnell, 5 Nebr. 423;
State v. Moore, 46 Nebr. 373, 64 N. W. 975;
Russell v. Purdue University, 201 Ind. 367, 168 N. E. 529, 65 A. L. R. 1384 (1929);
University v. Winston, 5 Stew. and P. (Ala.) 17;
Lewis v. Whittle, 77 Va. 415;
Grigsby v. Bank, 158 Tenn. 182, 184, 11 S. W. (2d) 673;
Fidelity Company v. Trustees, 16 F. (2d) 150;
Attorney General v. Knowles, 16 Fla. 577;

Head v. University, 47 Mo. 220;
State v. State University, 268 Mo. 598, 188 S. W. 128;
University of North Carolina v. Maultsby, 43 N. C. 257;
State v. Bryan, 50 Fla. 298, 39 So. 929;
Central University v. Walters, 122 Ky. 65, 90 S. W. 1066;
State v. Vicksburg, etc., 51 Miss. 361;
State v. Irvine, 14 Wyo. 318, 376, 84 P. 90;
McClain v. Regents, 124 Ore. 629, 265 P. 412;
In re Royer, 123 Cal. 614, 621, 56 P. 461;
Henn v. State University, 22 Ia. 185;
Phillips v. Virginia University, 87 Va. 472, 34 S. E. 66, 47 L. R. A. 284;
In re Thiel College, 216 Pa. 630, 66 A. 83;
Carrick v. Clark, 112 Tenn. 483, 80 S. W. 64;
State v. Clausen, 51 Wash. 548, 99 P. 748;
Ross v. Trustees, 31 Wyo. 464, 228 P. 642;
University v. Peoples Bank, 157 Tenn. 87 (1928).

In University v. Peoples Bank, supra, the court says:

"The University of Tennessee was not created for the benefit of a particular section of the state, and the property entrusted to it by the state is devoted to the use of the entire public, in the performance by the state of a governmental function."

Elementary Schools and Other Educational Agencies

The legal conclusion that boards or bodies charged with the duty of conducting institutions of higher learning, like universities, colleges and normal schools, are public corporations, as distinguished from the ordinary corporation, was the logical and necessary outgrowth of the state policy, adopted in some instances more than two centuries before

the Federal Constitution, that education, as stated by Marshall in the Dartmouth College case, "is a . . . proper subject of legislation." That the doctrine should be extended to other agencies created for the purpose of disseminating knowledge at state expense, or under state supervision and control, or both, was equally reasonable, and, in fact, imperative. The ruling rests upon the principle that education, in all its branches, from the primary schools to the university, from the technical school to the Colleges of Medicine and Law, is an enterprise which should at all times be conducted under the supervision of the state, and which the state itself may undertake. This principle forms the basis of the legal rule which, in a variety of situations, has resulted in judicial pronouncements either that the agency is not suable, or that it is not liable in tort, because it is a governmental instrumentality. It has been accordingly held that educational agencies of various kinds, such as agricultural or state fairs (Morrison v. MacLaren, 160 Wisc. 621, 152 N. W. 475, L. R. A. 1915 E 469, decided in 1915; Zoeller v. State Board of Agriculture, 163 Ky. 446, 173 S. W. 1143, decided in 1915; Minear v. State Board, 259 Ill. 549, 102 N. E. 1082, Ann. Cas. 1914 B 1290; Melvin v. State, 121 Cal. 16, 53 P. 416, decided in 1898; Hern v. Iowa, etc., Society, 91 Ia. 97, 58 N. W. 1092, decided in 1894; Berman v. Minn. etc., Soc., 93 Minn. 125, 100 N. W. 732, decided in 1904), state educational institutions (Abston v. Waldon Academy, 118 Tenn. 24, 102 S. W. 351, decided in 1906; Alabama School v. Reynolds, 113 Ala. 579, 42 So. 114, decided in 1905; Alabama School v. Adler, 114 Ala. 555, 42 So. 116, decided in 1905; Oklahoma College v. Willis, 6 Okla. 593, 52 P. 921, decided in 1898; Jorgens v. State, 2 Ct. Cl. (Ill.) 134, decided in 1911; Hale v. Williams, 10 N. S. Wales 638, decided in 1910), boards of education (Kinnare v. Chicago, 171 Ill. 332, 49 N. E. 536, decided in

1898; Daniels v. Board of Education, 191 Mich. 339, 158 N. W. 23, L. R. A. 1916 F 468; Board of Education v. Volk, 72 Ohio St. 469, 74 N. E. 646, decided in 1905; Wahrman v. Board, 187 N. Y. 331, 80 N. E. 192, decided in 1907; Jaked v. Board, 198 App. Div. 113, 189 N. Y. S. 697, decided in 1921; Herman v. Board, 234 N. Y. 196, 137 N. E. 24, decided in 1922; Hill v. Boston, 122 Mass. 344; Folk v. Milwaukee, 108 Wisc. 359, 84 N. W. 320; Sullivan v. School Dist., 179 Wisc. 502, 191 N. W. 1020; Anderson v. Board, 49 N. D. 181, 190 N. W. 806; Ferris v. Board, 122 Mich. 315; 81 N. W. 98, decided in 1899; Wixon v. Newport, 13 R. I. 454; Charles Bank v. Brainerd Dist., 49 Minn. 106, 51 N. W. 814; Ford v. Kendall Dist., 121 Pa. St. 543, 15 A. 812; State v. Frederick Co., 94 Md. 334, 51 A. 289; Curran v. Boston, 151 Mass. 505, 509, 24 N. E. 781), a school for children of the slums (Kellar v. Los Angeles, 179 Cal. 605, 178 P. 505, decided in 1919), and school districts (Wiest v. School Dist., 68 Ore. 474, 137 P. 749, 49 L. R. A. (N. S.) 1026, decided in 1914; Juul v. School Dist., 168 Wisc. 111, 169 N. W. 309, 9 A. L. R. 904, decided in 1918; Stovall v. School Dist., 110 Wash. 97, 188 P. 12, 9 A. L. R. 908, decided in 1920), are *public instrumentalities or public corporations*.

To sum up, then, these boards, public bodies and school districts have been held public agencies, or public corporations, endowed with a portion of the sovereignty of the state, not suable in tort, or not liable in tort, except when made so by statute, for the reason that they were exerting a portion of the state's sovereignty, imposed upon them by law, without expectation or hope of pecuniary profit, and in the public, or the general, as distinguished from the private, or local, interest. However unsatisfactory the grounds of decision, as they have been variously stated, may be, the principle is clear, namely, that agencies engaged in conducting

educational activities of the type mentioned, created by the state for that purpose and maintained by the state, in whole or in part, by taxes or by funds owned by the state, are public agencies or corporations and inherently partake, to no extent and in no degree of the character, the rights or liabilities of private corporations.

State ex rel. v. Chase, 175 Minn. 259, 262, 220 N. W. 951, holds that education is one of the ends of state government. The court says: "Education being one of those ends and the university the premier of the State's educational system, the system is, in the ordinary and functional sense, plainly an agency of the State."

Again; "It does not imply that the institution is not a mere instrumentality or agency of government in a functional sense." In Minnesota it is well established that the university is a state institution; that its governing board "is a public corporation, a trustee or agent of the state with specified and limited powers for use in a particular manner for a given end." Pp. 262, 263.

"The trustees of the University of Wyoming is a corporation created by statute as an agency of the state through which it manages the affairs of the state university." Fidelity Company v. Trustees, 16 F. (2d) 150.

"The University, though declared by statute to be body corporate by specified name, is not separate from or independent of the state, but is so much a dependent part of it that, even on a vesting of title in it of public lands of the state, the lands would still remain lands of the state." Amplifying the statement at pages 651 and 652 (226 Pacific), the court says: "and so far as the courts have passed upon the question of the relationship between the state and an educational institution created and maintained by it for a public purpose, the dependent position of the latter, as a mere state agency with respect to property or funds granted

to the state for the purposes of the institution, is well established." Ross v. Trustees, 31 Wyo. 464, 228 P. 642, Syllabus No. 12. Very specific on the same point is University v. Peoples Bank, 157 Tenn. 87, cited and quoted supra, p. 9.

B

"Governmental Functions"

When a public body or corporation is engaged in an activity under a duty imposed upon it by the sovereign, from which neither that corporation nor the sovereign expects, or in fact receives, financial or material profit; which is mainly supported either by general taxation or by property or funds, from whatever source derived, that are the absolute property of the agency or of the sovereign; which, in the light of customary and current opinion, is believed to bring benefits, tangible or intangible, to all the people in their collective and individual capacities; and which, as a governmental activity, is sanctioned by time, the course and usage of the government, and the unbroken and universal acquiescence of the people; that corporation is engaged in an activity of a strictly governmental character and there is a reciprocal prohibition, equally binding on the sovereign state and the National Government, against the exercise of the power of taxation by one upon the property which the other uses in the performance of the function.

1. *Governmental and proprietary functions of public corporations*

Public corporations possess two kinds of powers: ". . . . one governmental and public, and to the extent that they are held and exercised, is clothed with sovereignty—the other private, and to the extent that they are held and exercised, is a legal individual. The former are given and used for public purposes, the latter for private purposes. While in the exercise of the

former, the corporation is a municipal government, and while in the exercise of the latter, is a corporate, legal individual." Lloyd v. City of New York, 5 N. Y. 369, 374 (1851).

The attempt in tort cases to apply this doctrine in actual controversies has resulted in endless confusion. Nevertheless, the formula exists. In the field of torts the way out seems to be a legislative or judicial pronouncement that municipalities shall be liable in all cases, or in none. The majority of the courts have sought to distinguish the one type of activity from the other, but without laying down rules by which we may be guided in determining whether a particular activity is one or the other. Indeed, as said in the Lloyd case, supra, "All that can be done, with safety, is, to determine, as each case arises, under which class it falls."

The United States Supreme Court, in South Carolina v. United States, 199 U. S. 437, 50 L. ed. 261, invoked this formula and held that an agent of the state, in conducting a liquor dispensary system, was performing a proprietary rather than a governmental function and was, accordingly, subject to the federal excise laws. This court did not define the phrase "private business," or suggest what activities are inherently governmental and what necessarily proprietary. The formula, in all its convenient—or inconvenient—vagueness, has been adopted, by this Court.

We are forced here, as indeed, in many situations, to reason from the analogies of the law. Some aid may be derived from a consideration of the grounds on which courts base their holding that an agency is not suable in tort, or that a tax is levied for a public purpose. In the cases denying the right to sue a municipality in a tort action it is sometimes urged as a reason for non-suability that no profit is derived or expected from the undertaking (Howard v. City, 153 Mass. 426, 77 N. E. 11; Lynch v. North Yakima, 37 Wash.

657, 80 P. 79), that no master-servant relationship exists, thereby rendering inapplicable the doctrine of respondeat superior (Abbott, Mun. Corp. Sec. 673; Dillon, Mun. Corp., 5th ed., Sec. 1655; Thompson, Com. on the Law of Negligence, Sec. 5796), and lastly—probably the true basis of the holding—that municipal corporations are agents of the sovereign, the *involuntary* character of the agency being emphasized (City v. Loy, 185 Ind. 18, 110 N. E. 694; Dillon, supra, 5th ed., Sec. 109), which itself is not liable to suit, and that it would, therefore, be a legal anomaly to hold the agent liable to private suit (Cooley, Torts, V. 2, 3rd ed. 1303 and cases cited).

No satisfactory differentiation between governmental and proprietary functions has been made in the tort cases. When a public corporation or agency is engaged in an activity, under a duty imposed upon it by the state (Denver v. Davis, 30 Colo. 370, 86 P. 1027; Markwardt v. Guthrie, 18 Okla. 32, 90 P. 26), from which neither it nor the state expects or, in fact, derives financial or material profit; which is mainly supported by general taxation (Welsh v. Rutland, 56 Vt. 288; Markwardt v. Guthrie, supra), or by funds which are the property of the state; which, in the light of customary and current opinion, is believed to bring benefits, whether tangible or intangible, to the people in their collective and individual capacities; and which, as a governmental activity, is sanctioned by time, the course and usage of the government, and the unbroken and universal acquiescence of the people (Topeka v. Loan Association, 20 Wall. 655, 22 L. ed. 455), that corporation or agency, we believe, is engaged in an activity strictly governmental in character, and there is a reciprocal prohibition, equally binding on the state and the nation, against the exercise of the power of taxation by one upon the property which the other uses in the performance of the function.

The author of this brief concedes that it is beyond his capacity to draft a definition which will adequately meet all cases. It is believed, however, that the syllabic paragraph, at the beginning of this section of the brief, though neither exclusive nor all inclusive, is a sound and correct statement of principle. There are certain services, which, through long experience and by common consent, have come to be looked upon as peculiarly within the province of government, and which, although private corporations may, to a limited degree, perform some of them, are, nevertheless, such that the public interest is deemed to be better served by having the activities either under the control of, or performed by the government itself. In this class it is believed belong such activities as law-making, the administration of justice and enforcing peace and order and obedience to the law, fire protection, the protection of the public health, and education of the citizens. There is substantial unanimity among the authorities in denying public liability in cases arising in these fields, on the ground that the function is governmental.

Is there any reason why an activity which is held governmental in the field of torts, should be held to be proprietary in the field of federal taxation? It is not perceived that any logical or reasonable basis for distinction exists. If a public corporation, created by the legislature and by it bound to operate a school, cannot be held liable in tort because it is a governmental agency of the state, the government in this case must accept the burden to show why the property of such a body, or the income of its agents, used in performing the duties laid on it by the law of the state, may be taxed by the United States because employed in a proprietary activity. The soundness or unsoundness of the distinction in tort cases is not here material. The formula has been imported into the law of federal taxation by the Supreme Court of the United States, and the government must suggest, or

else fail on this point, some rational basis for holding the activity proprietary in the case at bar, when state and federal courts have generally held the same activity governmental in the tort cases. In Coronado Oil Co. v. Burnet, 50 Fed. (2d) 998, it is assumed that education is a governmental function."

2. *Public support of higher education before 1787.*

Whether the school be of elementary or of college grade is immaterial upon the question whether the activity be governmental or proprietary. "The terms school, college and university convey the same idea, differing only in grade. Each indicates an institution of learning, consisting of trustees, teachers and scholars. . . ." State v. Erickson, 75 Mont. 429, 441, 244 P. 287.

In this subdivision, nevertheless, we shall deal mainly with higher education.

Before and at the time the thirteen original colonies ratified the Federal Constitution, it had been generally recognized that the maintenance and operation of schools of elementary and college grade at public expense was a proper and necessary state function; and several had definitely adopted the policy of maintaining seminaries and colleges at public expense. It is important to bear in mind that when the delegates assembled in Philadelphia in 1787, they, and especially the leaders among them, were thoroughly conversant with this colonial policy.

In 1780 Massachusetts adopted a Constitution, or form of government, for the Commonwealth. In section 1 of Article I of Chapter 5 of that instrument specific and emphatic acknowledgment is made of the fact that Harvard University had initiated many persons of great eminence into those arts and sciences which qualified them for public employment. In Chapter 5, Section 2, of the same document, it is said: "Wisdom and knowledge, as well as virtue, diffused generally among the body of the people, being neces-

sary for the preservation of their rights and liberties; and as these depend on spreading the opportunities and advantages of education in the various parts of the country, and among the different orders of the people, *it shall be the duty of legislatures and magistrates,* in all future periods of this Commonwealth, *to cherish the interests of literature and the sciences,* and all seminaries of them; especially the University of Cambridge (as early as 1742 supported by public levies) public schools and grammar schools in the towns. . . ."

In the Constitution of Georgia, 1787, Article 54, it is said: "Schools shall be erected in each county, and supported at the general expense of the State as the legislature shall hereafter point out."

Connecticut, before it could erect a college of its own and before the Federal Constitution was ratified, contributed to the support of Harvard at Cambridge. Prior to 1718, what was to become Yale University was publicly supported in Connecticut. 11 C. J. 973, note. In the Constitution of 1818, Article VIII, section 2, we find the public school fund secured inviolably against encroachment or use for any other than educational purposes. This fund apparently antedated the Constitution of 1818.

In the Constitution of New Hampshire of 1784 we find this statement: "Knowledge and learning, generally diffused through a community, being essential to the preservation of a free government; and spreading the opportunities and advantages of education through the various parts of the county, being highly conducive to promote this end; it shall be the duty of the legislators and the magistrates, in all future periods of this Commonwealth to cherish the interests of literature and the sciences, and all seminaries and public schools . . . ."

In the Constitution of North Carolina, approved in 1776,

we find a similar provision, as apears from the ensuing quotation: "XLI. That a school or schools shall be established by the Legislature, for the convenient instruction of youth, with such salaries to the masters, paid by the public, as may enable them to instruct at low prices; and all useful learning shall be duly encouraged, and promoted, in one or more universities." The University of North Carolina was chartered in 1789 and opened its doors to students in 1795.

Virginia had, prior to the Revolution, made grants of public land and of public money for the support of education and particularly for the support of the College of William and Mary.

In New York, as early as 1784, the state had created a state board for educational purposes, known as the Board of Regents of the University of the State of New York, which body is still an important part of the governmental machinery of that State.

In Pennsylvania the Constitution adopted in 1776, Section 44, provides: "A school or schools shall be established in each county by the legislature for the convenient instruction of youth . . . and all useful learning shall be duly encouraged and promoted in one or more universities." And in the same state, Article VII, Section 1, Constitution of 1790, provides for free public schools and for one or more seminaries of learning.

Vermont came into the Union in 1790. In 1777 Vermont had adopted a Constitution in which it was provided: "One grammar school in each county and one university in this state, ought to be established by direction of the general assembly." In the Constitution of Vermont, adopted in 1786, it was asserted that a competent number of schools ought to be maintained in each town for the convenient instruction of youth and "one or more grammar schools be incorporated, and properly supported in each county of this state."

To refer again to the history of Virginia, Thomas Jefferson, in 1779, introduced into the Legislature of Virginia his famous bill for a more general diffusion of knowledge, which embodied a plan for a public school system in that state. And George Washington, in his First Message to Congress, in 1790, emphasized the importance of education as a means of maintaining the security of the newly adopted Constitution.

In 1782 the Legislature of Maryland founded a College at Chestertown. In the preamble the following appears:

> "Whereas institutions for the liberal education of youth in the principles of virtue, knowledge, and useful literature, are of the highest benefit to society, in order to raise up and perpetuate a succession of able and honest men for discharging the various offices and duties of the community, both civil and religious, with usefulness and reputation, and such institutions of learning have accordingly merited and received the attention and encouragement of the wisest and best regulated states . . . ." Act of 1782, Chapter 8.

In 1784 the Maryland Legislature founded the University of Maryland. In addition to the language of the Act of 1782, quoted supra, we find that body again expressing its opinion that education is a state matter. (Act of 1784, Chapter 37.)

The Federal Congress itself, has, from its very inception, recognized the fact that education is not only properly an activity for the states, but that control thereof is essentially and strictly a governmental function. Indeed, Congress has made the maintaining and operating of a state school system a condition of admission to the Union. The pronouncement in the Ordinance of 1787 is well known. It is there said that religion, morality and knowledge are necessary to *good government* and to the happiness of mankind, and that schools and the means of education "shall forever be encouraged."

In 1785, on May 20, Congress, at New York, passed an ordinance reserving section 15 in every township for the maintenance of "public schools within said township." Journals of Congress, May 20, 1785. A similar reservation was thereafter made in substantially all acts providing for the sale of public land. The schools thus supported were, of course, generally under state or public control. This Congressional policy has been continuous and consistent. Beginning with the Land Grant Act of 1826, Congress has repeatedly appropriated public property or funds to be used by the states in educational work. Other acts are the Land Grant Act of 1862, approved by President Lincoln; the Hatch Act of 1881; the Morrill Act of 1890; the Adams Act of 1906; the Nelson Act of 1907; the Smith-Lever Act of 1914; the Smith-Hughes Act of 1917; and the Purnell Act of 1925.

Attention is also called to a volume by E. W. Clews entitled "Educational Legislation and Administration of the Colonial Government," an authoritative historical work. Without going into detail, we are told that the Massachusetts Colony, fully one hundred years before the Constitution was adopted, expended public funds for the promotion of higher education; that in Connecticut, as early as 1715, public property and funds were appropriated for the advancement of college education; in New Hampshire, in 1693, and again in 1719, provision was made for the support of education through public taxation; and in Rhode Island, on February 17, 1764, the Legislature passed an act for the incorporation of the schools, in which it was averred, among other things, "Every wise and well regulated state" gives attention to the spread of knowledge among the people. This act pertained to *higher education*, as well as to the primary subjects. In New York, in 1764, Kings College was founded by a public act. In 1740 the City of Philadelphia appropri-

ated 1200 pounds, and one thousand pounds annually for a period of five years, for the support of an academy. In New York State likewise, as early as 1737, public funds were appropriated for the teaching of Latin, Greek, etc.

It thus appears that higher education was supported by general taxation in some colonies more than a century before the Constitution was adopted, a fact fully appreciated by the gentlemen who framed the Constitution in Philadelphia in 1787.

It is improbable that a single leader of the movement for independence or a single framer of the Federal Constitution, did not believe firmly in the imperative necessity, not only of widespread popular education, as afforded by the common schools, so-called, but in the need for seminaries, colleges and universities operated by the state at public expense for the dissemination of knowledge in the higher branches. The Federal Constitution is silent on the subject of a National University and upon the subject of education from no want of appreciation of its importance; the framers of that instrument came from states which had taken steps to maintain a school system at public expense, and they rejected the proposal to found a National University for the reason, as pointed out by Roger Sherman in a debate in Congress later (Farrand, Proc. Const. Convention. Vol. III, Appendix A, CCLV; p. 362), that it was deemed to be the peculiar concern of the states. At the time of the adoption of the instrument the states had taken definite steps in the direction of promoting popular and college education at general expense. *The power was consciously reserved by the states.* The conclusion seems to be inescapable that at the time of the adoption of the Federal Constitution in 1787 the conviction was general that education was essentially an interest of the states and control thereof a governmental function.

C.

Police Power and Education

1. *When the sovereign act is an exercise of the police power, the function is governmental in character. Normal School v. Charleston, 271 Ill. 602. Education is one of the purposes for which the police power may be exercised.*

That education is one of the purposes for which the police power may be exercised, is no longer open to doubt.

"But neither the Amendment (Fourteenth)—broad and comprehensive as it is—nor any other amendment, was designed to interfere with the power of the state, sometimes termed the police power, to prescribe regulations to promote the health, peace, morals, *education*, and good order of the people . . . ." Barbier v. Connolly, 5 Sup. Ct. 357, 113 U. S. 31.

"Education is one of the purposes for which what is called the police power may be exercised. Massachusetts always has recognized it as one of the first objects of public care." Interstate Co. v. Massachusetts, 207 U. S. 79, 87, per Holmes, J.

"As a police regulation in the interest of *education*, the law may well require street railway companies to permit these children to ride to school upon their cars, without profit to the companies, provided it can be done without causing them loss." Com. v. Interst., etc., Ry. Co., 187 Mass. 436. Sustained by the Supreme Court, but on other grounds. Justice Holmes thinks it a proper exercise of the police power. If education were proprietary, such a requirement would obviously be illegal. The police power cannot be exercised by or for the peculiar benefit of private persons. See Owensboro, etc., Co. v. Todd, 91 Ky. 175, 5 S. W. 56, 11 L. R. A. 285; 43 C. J. 228, Notes 57-59.

2. *The power of the state to compel parents and guardians to send children to the public schools or to suitable substitutes for the public schools, cannot be vindicated upon any theory of education as a proprietary activity.*

The state may not *require all* children to attend the public schools. To do so is to infringe the guaranty of liberty found in the Fourteenth Amendment. Pierce v. Society, 268 U. S. 510, 45 S. Ct., 571 69 L. ed. 1070, 39 A. L. R. 468. This case and Meyer v. Nebraska, 262 U. S. 390, 67 L. ed. 1042, 29 A. L. R. 1446, settled the rule to be that while a state may require the attendance of pupils and the pursuit of certain courses, at *a* competent school, it cannot compel the pupil to attend *the public* schools. The state may compel *education somewhere,* but may not limit the right of the *citizen*-parent reasonably to choose the school where education is imparted. See State v. Hoyt (N. H.), 146 A. 170.

A statute which gives the juvenile court power to enforce rules of discipline in the public schools (such a holding would be improper, if the function were proprietary) is constitutional and proper. Bishop v. Houston, etc., Tex. Com. of Appeals, 29 S. W. 312 (1930).

State v. Bailey, 157 Ind. 324, 61 N. E. 734 (1901). The parent owes the duty to educate the child, not just to the child itself, but to the state. "The welfare of the child, and the best interests of society require that the state shall exert its sovereign authority to secure to the child the opportunity to acquire an education."

State v. Clottu, 33 Ind. 409, 411 (1870). "The matter of education is deemed a legitimate function of the state. . . ."

Farnum's petition, 51 N. H. 376, 378. The subject of education is one "of public concern, to be cherished, regulated and controlled by the state."

"The Federal Constitution does not provide for any gen-

eral system of education to be conducted and controlled by the National Government. It is distinctly a state affair." Piper v. Big Pine School Dist., 193 Cal. 664, 226 P. 926 (1924).

"No case has been cited by counsel, and none has been discovered by us, although we have searched the reports with care, which denies the doctrine that the regulation of the public schools is a state matter, exclusively within the domain of the Legislature." Clark v. Haworth, 122 Ind. 462, 7 L. R. A. 249, 23 N. E. 946.

"Free schooling furnished by the state is not so much a right granted to the pupils as a duty imposed upon them for the public good. If they do not voluntarily attend the schools provided for them, they may be compelled to do so. The object of the school laws is to guard against the dangers of incompetent citizenship." Fogg v. Board, 76 N. H. 296, 299, 82 A. 173, 175, 37 L. R. A. (N. S.) 1110, Ann. Cas. 1912 C 758. See Marland v. U. S. 53 F. (2d) 907, especially the opinion of Mr. Justice Littleton at page 910. ff.

If education were proprietary, like liquor, cotton, coal, electricity, water, or gas, it is obvious that while a public corporation might dispense all these commodities for the benefit of a local public, it could not compel the citizen either to use only the public product or a product of substantially equivalent quality.

Conclusion

The contention that conducting a school system is not a strictly governmental function finds support neither in legal logic nor in common experience. The law is much less the child of abstract reasoning than of the ordinary experience of ordinary persons. Legal logic detached from practical life is simply intellectual gymnastics. The law has been a steady growth, and one function of logic has been to relate or apply it to steadily changing human relations. As said by Justice

Holmes, "The life of the law has not been logic, it has been experience." Although cast in the mould of a written constitution, our political system was a distinct and novel experiment, and the mould must have elasticity or break under the pressure of actual trial. In the course of time it has turned out that the states have wholly controlled the course of education, to the exclusion of the Federal Government. It is too late to urge dictionary or abstract definitions of "government," or "governmental," or dry axioms or formal concepts of legal logic or political philosophy in order to support the sophism that managing a school is a proprietary business.

Ever since society took on definite form on this side of the Atlantic, the theory and practice of our people have recognized education as a fundamental concern of the state as a whole. Is not the combined judgment of all the state courts as to what is a governmental function virtually conclusive? When we recall the great diversity of judicial opinion in nearly every field of the law, the unanimity of the decisions on this point takes on a tremendous significance. In this instance, at least, if not in some others which perhaps might be cited, the courts have given expression to the inarticulate sentiment of the nation, from the days of its founders to the present hour, that general enlightenment is one of the first conditions of permanent and successful democratic government. Education everywhere concerns the state; but in a republic, where all ultimate power rests in the citizen, expressing his will through the instrumentality of a secret ballot, it is simply impossible to overestimate the importance of his bringing to the task of casting his ballot a large measure of cultivated intelligence and correct information. Ignorance and indifference are the two arch enemies of free institutions. Both can be routed if our public school system fulfills its promise. Next to the maintaining of order, nothing is of greater concern to the state, as a whole, nothing more

vitally affects the well-being of society organized on the democratic principle, than education. That this principle promotes national policy has heretofore been demonstrated; and of compelling emphasis is the action of Congress in requiring the States to maintain a school system as a condition of admission to the Union. See Marland v. United States, 53 F. (2d) 907 (1931).

At this point the natural result of the contrary position may be noted. If education be not a governmental function, the federal government has the power to tax every school district, the right to conduct a school, no matter of what grade, the property and income of every school district and university, the right to teach, and the income of every teacher, in the United States. The Congress may require every teacher in the United States to pay a license fee in any amount it sees fit, as it did in the case of the agent of South Carolina in the liquor dispensary case. And Congress may tax the agents and employees of every charitable institution in the land which collects, from those financially able, compensation for the services rendered. To put the matter bluntly, the power of the Federal Government to tax the educational agencies of the states is left without limitations save those which may be imposed by a want of ingenuity in Congress to enact laws.

Respectfully submitted,

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March, 1932.

Amici Curiae

SUPREME COURT OF THE UNITED STATES.

No. 341.—October Term, 1931.

David Burnet, Commissioner of Internal Revenue, Petitioner,
vs.
Coronado Oil and Gas Company.

On Writ of Certiorari to the Court of Appeals of the District of Columbia.

[April 11, 1932.]

Mr. Justice McReynolds delivered the opinion of the Court.

By the Enabling Act Congress required as a condition precedent to the admission of Oklahoma into the Union that her constitution should make provision for common schools; and for their benefit it granted certain lands to the State with the proviso that those valuable for minerals, gas and oil should not be sold prior to January 1, 1915, but might be leased. Act of June 16, 1906, 34 Stat. 267, 270, 272, 273. The State Constitution established a common school system and pledged her faith to preserve the lands so conveyed by the United States as a sacred trust, "and to keep the same for the uses and purposes for which they were granted." The legislature prescribed regulations for leasing and directed payment of the proceeds into the school fund. Oklahoma Comp. Statutes of 1921, Sections 9415, 9417, 9423.

In January, 1[illegible], some of these lands were leased to the Coronado Oil and Gas Company; renewals followed in 1919. Under the first lease the State received fifty per cent and under the second twelve and one-half per cent of the gross production of oil and gas. During the years here important the lessee's entire income came from the sale of its portion of such output.

The Commissioner of Internal Revenue assessed income and excess-profits taxes upon the corporation's net income for 1917, 1918 and 1919. The Board of Tax Appeals approved his action; the Court of Appeals, District of Columbia, ruled otherwise. The latter held that the lease to the Coronado Company was an instrumentality of the State for the utilization of lands dedicated to the support of public schools and that to tax the fruits of the lease

would burden her in the performance of the governmental function of maintaining such schools. This conclusion, it properly thought, was necessary under *Gillespie* v. *Oklahoma*, 257 U. S. 501.

We are disposed to apply the doctrine of *Gillespie* v. *Oklahoma* strictly and only in circumstances closely analogous to those which it disclosed. In principle, however, the present claim of exemption cannot be distinguished from the one presented in the earlier cause and we adhere to the rule there approved.

True it is, as stated in *Group No. 1 Oil Corp.* v. *Bass*, 283 U. S. 279, 282, 283, "This Court has consistently held that where property or any interest in it has completely passed from the government to the purchaser, he can claim no immunity from taxation with respect to it, merely because it was once government-owned, or because the sale of it effected some government purpose. . . . Property which has thus passed from either the national or a state government to private ownership becomes a part of the common mass of property and subject to its common burdens." And as there distinctly indicated the exemption claimed by the Oil Corporation was denied because under the settled rule applied by the Texas Supreme Court the oil and gas from disposal of which the corporate income arose had been purchased, not obtained under a lease—title had passed out of the State by a present sale. Status of the title was matter for determination under laws of the State as construed and applied by her courts. In the present cause there is no basis for saying that according to the local law, the transaction between the State and the lessee amounted to a sale. The distinction between cases involving sales and those where leases had been made seemed sufficiently apparent when *Group No. 1 Oil Corp.* v. *Bass*, was decided and is not less obvious now.

"Just what instrumentalities of either a state or the federal government are exempt from taxation by the other cannot be stated in terms of universal application. But this Court has repeatedly held that those agencies through which either government immediately and directly exercises its sovereign powers, are immune from the taxing power of the other." *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, 522.

The opinion in *Gillespie* v. *Oklahoma, supra*, has often been referred to as the expression of an accepted principle. *Metcalf & Eddy* v. *Mitchell, supra; Jaybird Mining Co.* v. *Weir*, 271 U. S. 609, 613; *Northwestern Insurance Co.* v. *Wisconsin*, 275 U. S.

136, 140; *Heiner* v. *Colonial Trust Co.*, 275 U. S. 232, 234; *Shaw* v. *Oil Corporation*, 276 U. S. 575, 579; *Panhandle Oil Co.* v. *Knox*, 277 U. S. 218, 221, 222; *Carpenter* v. *Shaw*, 280 U. S. 363, 366; *Willcuts* v. *Bunn*, 282 U. S. 216, 229; *Group No. 1 Oil Corp.* v. *Bass, supra; Indian Motorcycle Co.* v. *United States*, 283 U. S. 570, 576; *Choteau* v. *Burnet*, 283 U. S. 691, 696.

When Oklahoma undertook to lease her public lands for the benefit of the public schools she exercised a function strictly governmental in character. Consequently, *South Carolina* v. *United States*, 199 U. S. 437, much relied upon, is not in point.

The States are essential parts of the plan adopted by the Federal Constitution; and we accept as settled doctrine that the United States can lay no tax upon their governmental instrumentalities. *Texas* v. *White*, 7 Wall. 700, 725; *Collector* v. *Day*, 11 Wall. 113; *Pollock* v. *Farmers Loan & Trust Co.*, 157 U. S. 429, 584; *Farmers Bank* v. *Minnesota*, 232 U. S. 516, 527.

"It is an established principle of our constitutional system of dual government that the instrumentalities, means and operations whereby the United States exercises its governmental powers are exempt from taxation by the States, and that the instrumentalities, means and operations whereby the States exert the governmental powers belonging to them are equally exempt from taxation by the United States." *Indian Motorcycle Co.* v. *United States, supra.* Each government is supreme in its sphere; and in order to preserve our dual system this fact must be given practical recognition.

Here the lease to the respondent was an instrumentality of the State for the purpose of carrying out her duty in respect of public schools. To tax the income of the lessee arising therefrom would amount to an imposition upon the lease itself.

The challenged judgment must be affirmed.

Affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.

SUPREME COURT OF THE UNITED STATES.

No. 341.—October Term, 1931.

David Burnet, Commissioner of Internal Revenue, Petitioner,
vs.
Coronado Oil and Gas Company.

On Writ of Certiorari to the Court of Appeals of the District of Columbia.

[April 11, 1932.]

Mr. Justice Stone.

I think the judgment below should be reversed and *Gillespie* v. *Oklahoma*, 257 U. S. 501, should be overruled. Neither can stand as the law of this Court consistently with the principles recently reaffirmed in *Group No. 1 Oil Corporation* v. *Bass*, 283 U. S. 279.

The State of Texas, like the State of Oklahoma, has set apart a portion of its public domain for educational purposes. It has granted oil and gas leases of these lands, not differing in any material respect from the Oklahoma lease involved in this case. The royalties received by the State from the leases are devoted to the University of Texas, as Oklahoma devotes the income derived from its leases to its public schools. In *Group No. 1 Oil Corporation* v. *Bass, supra*, decided less than a year ago, this Court, notwithstanding its decision in the *Gillespie* case that the income of the lessees of Indian oil lands could not be taxed by Oklahoma, upheld the right of the National Government to assess and collect a tax upon the income received by the lessee of one of the Texas leases, from the sale of oil produced from the leased land. It was pointed out that under Texas law the lessee, by virtue of his lease, became the owner of the oil underground and that the taxed income was derived from the sale of oil which was his own property. In upholding the tax the Court said (pp. 82-83):

"Property sold or otherwise disposed of by the government, either state or national, in order to raise revenue for government purposes, is in a broad sense a government instrumentality, with respect to which neither the property itself before sale, nor its sale by one government, may be taxed by the other. But it does not follow that the same property in the hands of the buyer, or his

use or enjoyment of it, or the income he derives from it, is also tax immune. New Brunswick *v.* United States, 276 U. S. 547; Forbes *v.* Gracey, 94 U. S. 762; Tucker *v.* Ferguson, 22 Wall. 527; see Weston *v.* Charleston, 2 Pet. 449, 468; Veazie Bank *v.* Fenno, 8 Wall. 533, 547. Theoretically, any tax imposed on the buyer with respect to the purchased property may have some effect on the price, and thus remotely and indirectly affect the selling government. We may assume that if the property is subject to tax after sale, the governmental seller will generally receive a less favorable price than if it were known in advance that the property in the hands of later owners, or even of the buyer alone, could not be taxed.

"But the remote and indirect effects upon the one government of such a non-discriminatory tax by the other have never been considered adequate grounds for thus aiding the one at the expense of the taxing power of the other. See Willcuts *v.* Bunn, 282 U. S. 216, 231; Educational Films Corp. *v.* Ward, 282 U. S. 379; Metcalf & Eddy *v.* Mitchell, 269 U. S. 514, 523-524. This Court has consistently held that where property or any interest in it has completely passed from the government to the purchaser, he can claim no immunity from taxation with respect to it, merely because it was once government owned, or because the sale of it effected some government purpose. New Brunswick *v.* United States, *supra;* Forbes *v.* Gracey, *supra;* Tucker *v.* Ferguson, *supra;* see Gromer *v.* Standard Dredging Co., 224 U. S. 362, 371; Choctaw, O. & G. R. Co. *v.* Mackey, 256 U. S. 531, 537; Central Pacific R. Co. *v.* California, 162 U. S. 91, 125; Railroad Co. *v.* Peniston, 18 Wall. 5, 35-37; Weston *v.* Charleston, *supra,* p. 468.

"Property which has thus passed from either the national or a state government to private ownership becomes a part of the common mass of property and subject to its common burdens. Denial to either government of the power to tax it, or income derived from it, in order to insure some remote and indirect antecedent benefit to the other, would be an encroachment on the sovereign power to tax, not justified by the implied constitutional restriction. See Weston *v.* Charleston, *supra,* p. 468."

The doctrine thus announced was not a new one. More than fifty years before, and long before the decision in the *Gillespie* case, it had been definitely decided in *Forbes* v. *Gracey,* 94 U. S. 762, that private mining claims granted by the Government in the public lands of the United States, and the ores and minerals derived from them, are subject to state taxation.

In deciding the *Group No. 1 Oil Corporation* case, it was not necessary to determine whether the result in that case would have been different if the oil, from the sale of which the taxpayer de-

rived his income, had become his only when severed from the soil, or whether there were other distinguishing features between that case and the *Gillespie* case. It was enough, there, that, as the taxed income was derived from the lessee's sale of the oil, title to which was, by the lease, vested in him before severance, the case was definitely controlled by precedents whose avowed principles the Court approved. Now, we are concerned with a lease identical with that involved in the *Gillespie* case, and comparison of it with the Texas lease is unavoidable. If we can find no distinction of substance between the operation and effect of the Texas leases and the Oklahoma leases, the *Gillespie* case should no longer be followed. That no such distinction can be drawn is obvious.

The leasing by the National Government of Indian oil lands in Oklahoma to private lessees, for the benefit of the Indians, and the leasing by Oklahoma of its school lands in like fashion, for the benefit of the schools of the state, are no more and no less governmental enterprises than the leasing by Texas of its oil lands for the benefit of the state university. Whatever the genesis of the particular public duty which each sovereignty has undertaken to perform, the method chosen and the instruments selected for its performance are the same. In each case there was the exercise of a function concededly governmental, but in each the only result, so far as the lessee was concerned, was the acquisition by him of certain property rights exclusively for his own benefit. In each the lessee was taxed on his profits, derived from his private business in the production and sale of oil and gas, which was his property. It cannot be said that the identical tax, thus levied, has any effect on Oklahoma differing from that on Texas. The fact, if it is a fact, that under the Oklahoma leases the lessees do not acquire ownership of the oil or gas until they have severed it from the soil, but before its sale, while the lessees under the Texas leases acquire it immediately on receipt of their leases, presents no distinguishing feature. All acquire private rights by governmental grant, from the exploitation of which they have derived income which, upon principles consistently applied by this Court, except in the Indian oil lease cases, and reiterated in the *Group No. 1 Oil Corporation* case, may be taxed as other income is taxed.

Since comparison of the two methods of disposing of state assets reveals only formal differences, this Court must now deal with an irreconcilable conflict in the theories upon which two of its de-

cisions rest. One, the *Gillespie* case, extends the doctrine of tax immunity, beyond any other case, to income from private business enterprises, merely because the property used in the business was acquired from a sovereign government which applies the proceeds of it to a governmental purpose. The other, and more recent, case, decided by the Court after full consideration of all the arguments now advanced as supporting the *Gillespie* case, restricted the immunity to the property of the sovereign government itself and to the income which the Government derives from it.

It is plain that if we place emphasis on the orderly administration of justice, rather than on a blind adherence to conflicting precedents, the *Gillespie* case must be overruled. It is true that for ten years the State of Oklahoma has been deprived, by the decision in that case, of taxes upon the income derived from private business of lessees of Indian lands in that state, but that is no reason why it should continue to be so deprived or why the National Government should now be denied the right to like taxes and at the same time be permitted to tax the income of the lessees under the Texas leases. No interest which could be subserved by so rigid an application of *stare decisis*, is superior to that of a system of justice based on a considered and consistent application of the Constitution of the United States.

Mr. Justice BRANDEIS, Mr. Justice ROBERTS and Mr. Justice CARDOZO join in this opinion.

SUPREME COURT OF THE UNITED STATES.

No. 341.—October Term, 1931.

David Burnet, Commissioner of Internal Revenue, Petitioner, *vs.* Coronado Oil and Gas Company.	On Writ of Certiorari to the Court of Appeals of the district of Columbia.

[April 11, 1932.]

Mr. Justice Brandeis.

Under the rule of *Gillespie* v. *Oklahoma* vast private incomes are being given immunity from state and federal taxation. I agree with Mr. Justice Stone that that case was wrongly decided and should now be frankly overruled. Merely to construe strictly its doctrine will not adequately protect the public revenues. Compare *Jaybird Mining Co.* v. *Weir*, 271 U. S. 609.

Stare decisis is not, like the rule of *res judicata*, a universal, inexorable command. "The rule of *stare decisis*, though one tending to consistency and uniformity of decision, is not inflexible. Whether it shall be followed or departed from is a question entirely within the discretion of the court, which is again called upon to consider a question once decided." *Hertz* v. *Woodman*, 218 U. S. 205, 212. *Stare decisis* is usually the wise policy, because in most matters it is more important that the applicable rule of law be settled than that it be settled right. Compare *National Bank* v. *Whitney*, 103 U. S. 99, 102. This is commonly true even where the error is a matter of serious concern, provided correction can be had by legislation.[1] But in cases involving the Federal Con-

[1]This Court has, in matters deemed important, occasionally overruled its earlier decisions although correction might have been secured by legislation. See Chicago & Eastern Illinois R. Co. *v.* Industrial Commission, 284 U. S. —, overruling Erie R. Co. *v.* Collins, 253 U. S. 77, and Erie R. Co. *v.* Szary, 253 U. S. 86; Gleason *v.* Seaboard Air Line Ry. Co., 278 U. S. 349, 357, in part overruling Friedlander *v.* Texas & Pacific Ry. Co., 130 U. S. 416; Lee *v.* Chesapeake & Ohio Ry. Co., 260 U. S. 653, 659, overruling Ex parte Wisner, 203 U. S. 449, and qualifying In re Moore, 209 U. S. 490; Boston Store *v.*

stitution, where correction through legislative action is practically impossible, this Court has often overruled its earlier decisions.[2] The Court bows to the lessons of experienec and the force of better

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American Graphophone Co., 246 U. S. 8, 25, and Motion Picture Co. *v.* Universal Film Co., 243 U. S. 502, 518, overruling Henry *v.* A. B. Dick Co., 224 U. S. 1; Rosen *v.* United States, 245 U. S. 467, 470, overruling United States *v.* Reid, 12 How. 361 [compare Greer *v.* United States, 245 U. S. 559, 561; Jin Fuey Moy *v.* United States, 254 U. S. 189, 195; Olmstead *v.* United States, 277 U. S. 438, 466]; Roberts *v.* Lewis, 153 U. S. 367, 377, overruling Giles *v.* Little, 104 U. S. 291; Kountze *v.* Omaha Hotel Co., 107 U. S. 378, 387, overruling Stafford *v.* Union Bank of Louisiana, 16 How. 135; United States *v.* Phelps, 107 U. S. 320, 323, overruling Shelton *v.* The Collector, 5 Wall. 113, 118; Hornbuckle *v.* Toombs, 18 Wall. 648, 652, 653, overruling Orchard *v.* Hughes, 1 Wall. 77, Noonan *v.* Lee, 2 Black 499, and Dunphy *v.* Kleinsmith, 11 Wall. 610; Mason *v.* Eldred, 6 Wall. 231, 238, in effect overruling Sheehy *v.* Mandeville, 6 Cranch. 253; Gazzam *v.* Etheridge, 20 How. 372, 377, 378, overruling Brown's Lessee *v.* Clements, 3 How. 650; Vidal *v.* Girard's Executors, 2 How. 127, qualifying Baptist Ass'n *v.* Hart's Executor's, 4 Wheat. 1; Gordon *v.* Ogden, 3 Pet. 33, 34, overruling Wilson *v.* Daniel, 3 Dall. 401; compare Brenham *v.* German American Bank, 144 U. S. 173, 187, overruling Rogers *v.* Burlington, 3 Wall. 654 and Mitchell *v.* Burlingham, 4 Wall. 270; Hudson *v.* Guestier, 6 Cranch. 281, 285, overruling Himely *v.* Rose, 4 Cranch. 241, 284. See also Fairfield *v.* County of Gallatin, 100 U. S. 47, 54, 55, and cases cited.

[2]Besides cases in note 4, see East Ohio Gas Co. *v.* Tax Commission, 283 U. S. 465, 472, overruling Pennsylvania Gas Co. *v.* Public Service Commission, 252 U. S. 23; Terral *v.* Burke Construction Co., 257 U. S. 529, 533, overruling Doyle *v.* Continental Insurance Co., 94 U. S. 535, and Security Mutual Life Insurance Co. *v.* Prewitt, 202 U. S. 246; Pennsylvania R. Co. *v.* Towers, 245 U. S. 6, 17, in part overruling Lake Shore & Michigan Southern Ry. Co. *v.* Smith, 173 U. S. 684; United States *v.* Nice, 241 U. S. 591, 601, overruling Matter of Heff, 197 U. S. 488; Garland *v.* Washington, 232 U. S. 642, 646, 647, overruling Crain *v.* United States, 162 U. S. 625; Pollock *v.* Farmers' Loan & Trust Co., 158 U. S. 601, in effect overruling Hylton *v.* United States, 3 Dall. 171; Leisy *v.* Hardin, 135 U. S. 100, 118, overruling Peirce *v.* New Hampshire, 5 How. 504; Leloup *v.* Port of Mobile, 127 U. S. 640, 647, overruling Osborne *v.* Mobile, 16 Wall. 479; Morgan *v.* United States, 113 U. S. 476, 496, overruling Texas *v.* White, 7 Wall. 700; Legal Tender Cases, 12 Wall. 457, 553, overruling Hepburn *v.* Griswold, 8 Wall. 603; The Belfast, 7 Wall. 624, 641, overruling in part Allen *v.* Newberry, 21 How. 244; The Propeller Genesee Chief, 12 How. 443, 456, overruling The Thomas Jefferson, 10 Wheat. 428, and The Steamboat Orleans *v.* Phoebus, 11 Pet. 175; Louisville, Cincinnati & Charleston R. Co. *v.* Letson, 2 How. 497, 554-556, overruling Commercial & Rail Road Bank *v.* Slocomb, 14 Pet. 60, and other cases, and qualifying Bank of the United States *v.* Deveaux, 5 Cranch. 61; compare Marshall *v.* Baltimore & Ohio R. Co., 16 How. 314, 325, 326, in turn

reasoning,[3] recognizing that the process of trial and error, so fruitful in the physical sciences, is appropriate also in the judicial function. Compare *Brinkerhoff-Faris Trust & Savings Co.* v. *Hill*, 281 U. S. 673, 681. Recently, it overruled several leading

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qualifying the Letson case, *supra*. Compare Helson *v.* Kentucky, 279 U. S. 245, 251, qualifying Crandall *v.* Nevada, 6 Wall. 35; Soñneborn Bros. *v.* Cureton, 262 U. S. 506, qualifying Texas Co. *v.* Brown, 258 U. S. 466; Bowman *v.* Continental Oil Co., 256 U. S. 642, and Standard Oil Co. *v.* Graves, 249 U. S. 389; Union Tank Line Co. *v.* Wright, 249 U. S. 275, 283, 284, qualifying Pullman Palace Car Co. *v.* Pennsylvania, 141 U. S. 18; Wheeler *v.* Sohmer, 233 U. S. 434, 440, qualifying Buck *v.* Beach, 206 U. S. 392 [compare Baldwin *v.* Missouri, 281 U. S. 586]; Home Telephone & Telegraph Co. *v.* City of Los Angeles, 227 U. S. 278, 294, qualifying Barney *v.* City of New York, 193 U. S. 430; Galveston, Harrisburg & San Antonio Ry. Co. *v.* Texas, 210 U. S. 217, 226, qualifying Maine *v.* Grand Trunk Ry. Co., 142 U. S. 217; In re Chapman, 166 U. S. 661, 670, qualifying Runkle *v.* United States, 122 U. S. 543, 555; New Orleans City & Lake R. Co. *v.* New Orleans, 143 U. S. 192, 195, qualifying Gordon *v.* Tax Appeal Court, 3 How. 133; Philadelphia S. S. Co. *v.* Pennsylvania, 122 U. S. 326, 342, qualifying State Tax on Railway Gross Receipts, 15 Wall. 284; Wabash, St. Louis & Pacific Ry. Co. *v.* Illinois, 118 U. S. 557, 568, 569, qualifying Peik *v.* Chicago & Northwestern Ry. Co., 94 U. S. 164; Kilbourn *v.* Thompson, 103 U. S. 168, 196-200, qualifying Anderson *v.* Dunn, 6 Wheat. 204. See also discussion of City of New York *v.* Miln, 11 Pet. 102, in Passenger Cases, 7 How. 283; that of Ficklen *v.* Shelby County Taxing District, 145 U. S. 1, in Crew Levick Co. *v.* Pennsylvania, 245 U. S. 292, 296, and in Texas Transport & Terminal Co. *v.* New Orleans, 264 U. S. 150, 153, 154; that of Gulf, Colorado & Santa Fe Ry. Co. *v.* Texas, 204 U. S. 403, in Baltimore & Ohio Southwestern *v.* Settle, 260 U. S. 166, 173.

Movement in constitutional interpretation and application—often involving no less striking departures from doctrines previously established—takes place also without specific overruling or qualification of the earlier cases. Compare, for example, Allgeyer *v.* Louisiana, 165 U. S. 578, with The Slaughter House Cases, 16 Wall. 36; Tyson *v.* Banton, 273 U. S. 418, with Munn *v.* Illinois, 94 U. S. 113; Muller *v.* Oregon, 208 U. S. 412, and Bunting *v.* Oregon, 243 U. S. 426, with Lochner *v.* New York, 178 U. S. 45.

[3]Compare Taney, C. J., in The Passenger Cases, 7 How. 283, 470: "After such opinions, judicially delivered, I had supposed that question to be settled, so far as any question upon the construction of the Constitution ought to be regarded as closed by the decision of this court. I do not, however, object to the revision of it, and am quite willing that it be regarded hereafter as the law of this court, that its opinion upon the construction of the Constitution is always open to discussion when it is supposed to have been founded in error, and that its judicial authority should hereafter depend altogether on the force of the reasoning by which it is supported."

See also Miller, J., dissenting, in Washington University *v.* Rouse, 8 Wall. 439, 444: "With as full respect for the authority of former decisions, as belongs, from teaching and habit, to judges trained in the common-law system

cases, when it concluded that the States should not have been permitted to exercise powers of taxation which it had theretofore repeatedly sanctioned.[4] In cases involving the Federal Constitution[5] the position of this Court is unlike that of the highest court of England, where the policy of *stare decisis* was formulated and is strictly applied to all classes of cases.[6] Parliament is free to correct any judicial error; and the remedy may be promptly invoked.

The reasons why this Court should refuse to follow an earlier constitutional decision which it deems erroneous are particularly strong where the question presented is one of applying, as dis-

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of jurisprudence, we think that there may be questions touching the powers of legislative bodies, which can never be finally closed by the decisions of a court. . . ."

Compare Field, J., in Barden *v.* Northern Pacific R. Co., 154 U. S. 288, 322: "It is more important that the court should be right upon later and more elaborate consideration of the cases than consistent with previous declarations. Those doctrines only will eventually stand which bear the strictest examination and the test of experience."

[4]See Alpha Cement Co. *v.* Massachusetts, 268 U. S. 203, 218, overruling Baltic Mining Co. *v.* Massachusetts, 231 U. S. 68; Farmers Loan & Trust Co. *v.* Minnesota, 280 U. S. 204, 209, overruling Blackstone *v.* Miller, 188 U. S. 189. See also Baldwin *v.* Missouri, 281 U. S. 586, 591; Beidler *v.* South Carolina Tax Commission, 282 U. S. 1, 8; First National Bank of Boston *v.* Maine, 284 U. S. —. During the twenty-seven years preceding the decision of Farmers Loan & Trust Co. *v.* Minnesota, Blackstone *v.* Miller had been cited with approval in this Court fifteen times. Compare Educational Films Corp. *v.* Ward, 282 U. S. 379, 392-394, and The Pacific Co. *v.* Johnson, decided today, qualifying Macallen Co. *v.* Massachusetts, 279 U. S. 620.

[5]The policy of *stare decisis* may be more appropriately applied to constitutional questions arising under the fundamental laws of those States whose constitution may be easily amended. The action following the decision in Ives *v.* South Buffalo Ry. Co., 201 N. Y. 271, shows how promptly a state constitution may be amended to correct an important decision deemed wrong. See Frankfurter and Landis, "The Business of the Supreme Court", pp. 193-198. In only two instances—the Eleventh and the Sixteenth Amendments—has the process of constitutional amendment been successfully resorted to, to nullify decisions of this Court. See Chisholm *v.* Georgia, 2 Dall. 419; Pollock *v.* Farmers' Loan & Trust Co., 158 U. S. 601. It required eighteen years of agitation after the decision in the Pollock case to secure the Sixteenth Amendment.

[6]Compare London Street Tramways Co. *v.* London County Council, (1898) A. C. 375; Stuart *v.* Bank of Montreal, 41 Sup. Ct. Can. 516. See Arthur L. Goodhart, "Case Law in England and America", 15 Cornell Law Quarterly, 173, 188, 193; E. K. Williams, "Stare Decisis", 4 Canadian Bar Review 289.

tinguished from what may accurately be called interpreting, the Constitution. In the cases which now come before us there is seldom any dispute as to the interpretation of any provision. The controversy is usually over the application to existing conditions of some well-recognized constitutional limitation.[7] This is strikingly true of cases under the due process clause when the question is whether a statute is unreasonable, arbitrary or capricious; of cases under the equal protection clause when the question is whether there is any reasonable basis for the classification made by a statute; and of cases under the commerce clause when the question is whether an admitted burden laid by a statute upon interstate commerce is so substantial as to be deemed direct. These issues resemble, fundamentally, that of reasonable care in negligence cases, the determination of which is ordinarily left to the verdict of the jury. In every such case the decision, in the first instance, is dependent upon the determination of what in legal parlance is called a fact, as distinguished from the declaration of a rule of law.[8] When the underlying fact has been found, the legal result follows inevitably. The circumstance that the decision of that fact is made by a court, instead of by a jury, should not be allowed to obscure its real character.

The issue presented by the case at bar is of the character of those discussed above. Here, also, the applicable provision of law is beyond dispute. Confessedly, the United States may not, by a tax, interfere substantially with the functions of a State. The question at issue is, whether, as a practical matter, it does so interfere by a statute which includes among the items on which its general income tax is laid, the profits derived by the taxpayer from operating some of the State's school lands under a lease. The question resembles closely that presented and decided in *Willcuts* v. *Bunn*, 282 U. S. 216, 230, 231. There, this Court examined the surrounding facts to determine whether "a federal tax on the profits of sales of such securities should be deemed, as a practical matter, to lay such a burden on the exercise of the State's borrowing power as to make it necessary to deny to the Federal Government the constitutional authority to impose the tax". The

[7]See Frankfurter and Landis, "The Business of the Supreme Court", pp. 307-318.

[8]Arthur W. Machen, Jr., "The Elasticity of the Constitution", 14 Harv. L. Rev. 273; Henry Wolf Biklé, "Judicial Determination of Questions of Fact Affecting the Constitutional Validity of Legislative Action". 38 Harv. L. Rev. 6.

validity of the tax, it held, depends upon "whether the prospect on the part of the ordinary investor of obtaining profit on the resale of such obligations is so important an element in inducing their acquisition that a federal tax on such profits, in common with profits derived from the sales of other property, constitutes any substantial interference with the functions of state governments." Obviously the matter for determination in *Willcuts* v. *Bunn*, although made by the highest court of the land, was, in essence, a matter of fact. Similarly, here, the question whether it would interfere substantially with the functions of the state government to permit the general income tax of the United States to include profits derived from the lease involves primarily the determination of a fact, not the decision of a proposition of law.

The doctrine of *res judicata* demands that a decision made by the highest court, whether it be a determination of a fact or a declaration of a rule of law, shall be accepted as a final disposition of the particular controversy, even if confessedly wrong. But the decision of the Court, if, in essence, merely the determination of a fact, is not entitled, in later controversies between other parties, to that sanction which, under the policy of *stare decisis*, is accorded to the decision of a proposition purely of law. For not only may the decision of the fact have been rendered upon an inadequate presentation of then existing conditions, but the conditions may have changed meanwhile. Compare *Abie State Bank* v. *Bryan*, 282 U. S. 765, 772. Moreover, the judgment of the Court in the earlier decision may have been influenced by prevailing views as to economic or social policy which have since been abandoned.[9] In cases involving constitutional issues of the character discussed, this Court must, in order to reach sound conclusions, feel free to bring its opinions into agreement with experience and with facts newly ascertained, so that its judicial authority may, as Mr. Chief Justice Taney said, "depend altogether on the force of the reasoning by which it is supported."

Mr. Justice STONE and Mr. Justice ROBERTS join in this opinion.

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[9] Roscoe Pound, "The Theory of Judicial Decision", 36 Harv. Law Rev. (1923), 641, 651; Ray A. Brown, "Due Process of Law, Police Power, and the Supreme Court", 40 Harv. L. Rev. (1927), 943, 961, 967; "Police Power—Legislation for Health and Personal Safety", 42 Harv. L. Rev. 866 (1929), 866, 867, 872; Percy H. Winfield, "Public Policy in the English Common Law", 42 Harv. L. Rev. (1928), 76, 101, 102. See Charles Warren, "The Supreme Court in United States History", Vol. III, pp. 470, 471.